



March 16, 1988

Jeffrey Parker
Deputy Chief Counsel
U.S. Sentencing Commission
1331 Pennsylvania Ave., N.W., Suite 1400
Washington, D.C. 20004

Dear Jeff,

Since you are still in the process of working on the next draft, I thought I should respond to your letter of March 3, 1988, which responds to my earlier comments on round #1. I will defer comments on the environmental/regulatory areas until I have had more time to work on these issues. Instead, I want to directly respond to some of the questions you raised in your memo.

1. General Comments (pp. 1-2)

The point of my second comment was simply that since the "total loss" is by definition greater than "annual loss," the optimal multipliers ought to be different depending on which loss rule you adopt. In the case of "total loss," the appropriate multiplier ought to be the overall probability of being detected for the violation, which (I believe) will generally be greater than the average annual probability of detection. This point is not the same as the one I made in my January paper, which was that the annual probability might actually decrease or stay the same, not increase as Nash assumes. A simple example might help:

Suppose in year 1, the probability of detection is .5, whereas in year 2, it is .7. Then, the "average annual" probability is .6; whereas the "total" probability is $.5 + (.5)(.7) = .85$. Clearly, using the total loss rule, you need a lower multiplier.

I don't want to belabor this point. In reality, we are going to have a difficult enough time estimating the multiplier. My only concern is that we have some sense of whether the multiplier is supposed to be an annual or overall one.

My third comment was meant to raise the issue about accounting for imprisonment, with full awareness that this might be politically infeasible. However, I do believe my basic point is correct. The theory says you ought to penalize the firm monetarily to the full extent of social costs (adjusted for detection), if possible. To impose imprisonment would require a reduction in the fine (not to mention the fact that prison is

socially costly itself). Your concern was that this might create an incentive for the firm to find a "fall guy." I really don't have a clue as to whether or not this would really be a problem. It does seem to me, however, that prosecutors ought to be able to distinguish between crimes committed by individual for their own personal benefit (for which they ought to be personally prosecuted) and those for which the individual committed the crime on behalf of the organization - maybe hoping to eventually reap the benefits through promotions, etc. (for which the corporations ought to be prosecuted alone). That was all I hoped for with this suggestion. Needless to say, I don't hold out much hope of seeing this distinction in any future guidelines!

§8C1.2 Fines for Offenses Not Governed by Guidelines

Unfortunately, I am not sure exactly what crimes are covered here, so it is not clear whether my earlier concerns are valid. If you haven't already done so, you might want to get a list of these "other" crimes together to make sure my concerns are irrelevant.

One possible example, however, is customs violations. For example, the costs associated with contaminated or otherwise harmful products might be taken into account (even if there was not a high risk of immediate danger, etc.) (Would this be covered already under Food, Drug & Agriculture?) In fact, there might be no identifiable victims or victim loss.

§8C2.2 Consumer Fraud

(b)(1) "specialized goods" - You are correct in asserting that the loss to a consumer of a good whose price is \$1 but value is zero, might be more than \$1 because that consumer might have been able to purchase another good for \$1 that provided more than \$1 in value (once you factor in consumer surplus). Moreover, this is more likely to be the case for goods in which there is relatively inelastic demand. However, I doubt that you can adequately capture this by resorting to the "specialized goods" distinction. First, I'm really not sure what "no prevailing market price" means. Second, without more elaboration and example, I don't think this will be consistently applied by judges. Third, it isn't an "all or nothing" proposition. In fact, the consumer surplus loss you mention is probably present in all such cases.

(b)(2) "cost of repair" - I didn't mean to suggest that you were double counting. Instead, I thought you could easily include repair costs in (a), and saw no rationale for the 10% minimum.

§8C3.14(a) General Adjustments to the Offense Index

My basic problem with including these adjustments is that they tend to duplicate what I believe will be the factors used by prosecutors to determine whether or not to hold individuals within the corporation liable. To the extent this is true, I don't want to use these same factors to increase the corporate fine. (If anything, they should decrease it!) As to the specific factors, I think that (b) and (c) are clearly areas you can eliminate. On the other hand, you might be correct in wanting to keep cooperation and self-reporting as adjustments, since they might offer important incentives.

§8E1.1 Probation.

You might note that I didn't complain about probation for companies with prior felony convictions (or management of the company with such records). Instead, my concern was with section (h), which essentially says - fire your management if they knew about the offense, or go on probation. This is probation with the "first bite of the apple." I don't think this is needed for deterrence purposes if we've already applied the optimal fine. Moreover, I think it is a bad policy for the reasons elaborated earlier.

My suggestion is to leave this provision open and solicit the views of regulatory agencies involved. My understanding is that EPA, for example, has been quite successful in getting certain types of environmental compliance programs instituted under probation schemes. It might be useful to hear their side of the story - i.e. in what types of cases and what types of remedies. If I had to make a first cut at a "policy statement" for probation, it would be as follows:

"If the court determines that the offender was involved in a long-term noncompliance with applicable regulations, it may order probation for the purpose of ensuring that the appropriate compliance program is instituted and completed."

I hope these comments are helpful. In the meantime, I will be working on environmental and other regulatory offenses.

Sincerely,



Mark A. Cohen
Assistant Professor of
Management

cc: Commissioner Block ✓
Bill Rhodes