

**ENTITY LIABILITY AND DETERRENCE:
RECENT REFORMS IN ITALY***

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Abstract

The need for deterrence and repression of “corporate” crimes has led the international community to identify a specific kind of firm criminal liability. Therefore, in such a context, the study and the comparison of the economic theories of corporate and individual criminal liability becomes crucial to determine the more efficient form of deterrence towards the minimisation of social costs, considering their different capacity to internalise the externalities generated by crimes. In this literature our contribution is dedicated to understand if, and in which ways, corporate criminal liability models opportunely reflect the interdependent strategic behaviour of firms and employees’; at the same time, the analysis focuses on how these norms and models evolve in order to take into account firms’ economic incentives. Our analysis is focused on the exposition of the controversial and weak points emerging from the enforcement of the Italian legislative decree 231/2001.

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“...obedience to law is not taken for granted, and public and private resources are generally spent in order both to prevent offences and to apprehend offenders.”

G. Becker 1968

1. Introduction.

The theory of criminal economy started growing in the early ‘70s, thanks to the efforts made by Gary Becker (1968)¹ in order to introduce a microeconomic approach in the study of criminals’ behaviour. Becker’s aim was to provide, through a strict analytic method, explicit evidence of the 18th-19th centuries philosophy elaborated by Montesquieu, C. Beccaria and J. Bentham.

The importance of classic economic analysis of crime concerns the aim to illustrate choices related either to individuals or to society. Consistent with other economic analysis, the comparison of choices, made by criminals, victims and State is always present. In particular, there are three key levels where choices and decision-making processes have to be considered.

First, the relationship between the crime sector and the entire economy, where studies are carried out on decisions related to the size and extent to which society decides to allocate resources; secondly, the analysis of the basic structure of the sector itself, concerning the decisions required among the police, the courts etc.; finally, the allocation and equity division and policy choices affecting the behaviour and performance of any single “*actor*” of the crime sector.

Becker’s approach, in contrast to the “*natural born criminal*” theory of Lombroso², assumes that beneath every individual decision to commit a crime, there is always a rational and well-pondered cost-benefit analysis.

In particular, Becker suggests three principal variable factors affecting the costs

¹ G.S. Becker, *Crime and Punishment: An Economic Approach*, in *Journal of Political Economy*, vol. 76, March-April 1968.

² Cesare Lombroso (1876) argued on a biological approach that led him to the conclusion that “... the criminal is recognizable for his psychological deviation...”

and benefits of criminal actions: *i*) the opportunity cost of crime where a criminal has less time to spend on non-criminal activities. In particular, the measure of this cost implies measuring several different kinds of variables: e.g. wage rates, education, unemployment, age, etc.; *ii*) the benefit engaging criminal activities varies according to the different crimes committed: e.g. considering crimes against property, the variable benefit consists of the value of goods to be stolen; *iii*) the cost of punishment in addition to the opportunity cost. Obviously this is only an expected cost but not certain.

According to Becker's assumption, the potential criminal acts like a rational economic agent. Thus, she compares *ex-ante* the expected crime benefit with the cost generated from her behaviour. The criminal "*homo economicus*", in other words, compares on one side the expected crime benefit with the risk of being captured and punished, and, on the other side, the opportunity cost of undertaking other remunerative activities.

It is evident that, in terms of incentives and minimization of social damages, crime cost plays a key role in the definition of anti-crime public policies. As a matter of fact, according to Montesquieu³ "... a good legislator will put less effort in punishing crimes rather than on preventing them; will be focused more on imparting moral values, *rather than to impose punishments*".

The deterrent effect, being a priority target of anti-crime policies, is directly related to the degree of efficiency of the criminal system and, therefore, to the resources employed by the community for investigating crimes, fixing criminal responsibilities and determining the efficient quantification of sanctions.

Our contribution is dedicated to understand if, and in which ways, corporate criminal liability models opportunely reflect the interdependent strategic behaviour of firms and employees; at the same time, the analysis focuses on how these norms and models evolve in order to take into account firms' economic incentives.

Our analysis is focused on the exposition of the controversial and weak points that emerge from the enforcement of the Italian legislative decree 231/2001.

The paper is organised as follows. Section two analyses the origin of the new entity liability tool. Section three concentrates on the details of the legislative decree 231/2001. Section four contains the microeconomic analysis of the new liability tool. Finally, section five, concludes.

³ Montesquieu (1784), *De l'esprit des lois*, Garnier-Flammarion, Paris.

2. The origin of legal entity's liability.

Starting from the assumption of means of repression and prevention of organized crime affecting economic sectors, it clearly emerges that companies (partnerships, firms, corporations), due to their own impersonal structure, have to be considered as potential agents that can carry out crimes whose negative consequences can reflect on the entire economic system.

Considering the basis on which an individual carries out her pro-crime calculation, we can affirm that, under an economic profile and with reference to the so called "crime under company coverage" (mainly frauds to the detriment of the Public Administration), the regime of individual criminal liability seems no more sufficient nor suitable to the internalisation of the external diseconomies produced through misconduct. As a matter of fact, in most cases, the perpetrator of the crime is insolvent and consequently unable to pay the effective monetary sanction. Therefore, she considers the cost of his behaviour always lower than her programmed benefit, thus the inclination towards crimes is higher.

In order to warrant the global market, the need to repress and prevent such crimes led the international community to go over the "brocardo"⁴ "*societas delinquere non potest*"⁵, thus identifying a specific form of companies' liability. In order to minimize their own direct and indirect social costs, the stated target by this new form of "paralegal" liability of companies consists of a system configuration, in which companies are induced to invest efficiently in controlling and monitoring the activities of their employees in apical positions (representation, administration and management of entities or other organizational units or persons who in effect exercise management and control), as well as, the employees under the management or supervision of the subordinate employees.

The pioneers in the international struggle against the worldwide criminality, and in the configuration of a specific liability of legal person, were the United States of America with the 1977 "*Foreign Corrupt Practices Act*". The introduction of this Act was required in the light of the consequences of the Lockheed scandal, where several American companies paid a considerable bribe to public officials of foreign states. The Act established penal sanctions against corruptive practices carried out abroad and severe accounting procedures for the whole economic transactions in addition to compulsory forms of internal control.

⁴ Italian word indicating the general rules of the law. This word was first used by "The School of glossators" of Bologna (12°-13° sec.) and considered by some as legal assumptions and by others as rendezvous points against other questionable opinions.

⁵ Entities are not able to commit crimes.

The international community did not immediately follow the American approach, and this determined an unfavourable position for the American companies competing in the international market. Only in 1997 the international community adopted the November 17th OECD Convention on the struggle against corruption of international markets, following the late awareness of the spread of corruptive practices and the consciousness of the negative effects in absence of a common punishment strategy.

Following the U.S. path, the Convention induced the participating states to fight and repress corruption of foreign officials, therefore introducing a liability tool for legal person and providing a new definition of transparent accounting procedures.

In Europe the main measures on this particular issue were first the so called *Pif* (1996 e 1997), consisting of protocols of the Conventions dealing with protection and financial interests of the E.C., and secondly, the E.U. Convention (1997), on the struggle against corruption involving the officials of the E.C. or its Member States.

These measures, even though more than 20 years later than the “*Foreign Corrupt Practices Act*”, contained a more rigid indication about the introduction of a homogeneous discipline for entities’ liability and common sanctions throughout all the Member States.

In Italy the implementation of conventions and relevant engagements undertaken at international level has been enforced through the law 300/2000. In particular, the Government has set forth procedures culminating in the introduction of entities liability (Legislative Decree 231/2001 concerning regulation of the administrative liability of legal entities, of companies and of associations including those without legal personality).

Thus, in this way, a hybrid form of responsibility, that includes specific elements both taken from crime and administrative liability, was introduced.

The use of the Law and Economics approach, in opposition to the Kelsian positivist doctrine, in our belief, represents the most valid analysis tool to analytically study and evaluate the impact of the Legislative Decree 231/2001 on the behaviour of the companies and the individuals directly involved.

3. Overview of the Decree 231/2001.

The Legislative Decree 231/2001 is the legal tool that enforces Law 300/2000, and which brings the Italian legislation in line with the already agreed international

conventions⁶.

The Decree introduces a regime stating “criminal” liability of legal entities for certain offences committed in their interest or for their advantage, which is additional to criminal liability of the natural person who materially perpetrates the fraud. Moreover, it extends liability to offences committed outside Italy, provided that no action is taken in connection therewith by the State in whose territory the offence was carried out. It includes a list of offences that are mainly against Public Administration, even though it does not preclude, in the future, the extension of the set of rules to other types of offences such as those perpetrated against the environment, fraudulent budget, false corporate communications and social relationships, etc.

Most of the decree’s prescriptions concern both people involved in perpetrating the offences and the different type of offences. In particular, the decree’s prescriptions are directed mainly to natural persons in apical position and other employees under their management or supervision. Several kinds of offences are taken into account, especially those against the Public Administration (e.g. corruption, extortion, fraud, bribery, to the detriment of the State or other public entities or against public officials).⁷

⁶ Brussels Convention of July 26, 1995 on the protection of the European Community’s financial interests, Brussels Convention of May 26 1997 on the fight against corruption involving officials of the E.C. or of Member States and the OECD Convention of December 17, 1997, on the campaign against corruption of foreign public officials in international business transactions.

⁷ The Decree also embodied other kinds of offences, following the enactment and entry into force of some successive laws. The Legislative Decree 350 dated September 25th, 2001 concerning “*urgent provisions in preparation for the introduction of the euro*”, has included offences pursuant to art 25-bis, such as: *a)* forgery of money, spending and introduction into the State, through prior agreement, of counterfeit money; *b)* alteration of money; *c)* spending and introduction into the State, without prior agreement, of counterfeit money; *d)* spending of counterfeit money received in good faith; *e)* forgery of revenue stamps, introduction into the State, purchase, possession or introduction into circulation of counterfeit revenue stamps; *f)* forgery of watermarked paper for use in the production of public credit cards or revenue stamps; *g)* use of counterfeit or adulterated revenue stamps.

The Legislative Decree No. 61 dated April 11th, 2002 concerning “*Regulation of criminal and public offences concerning business organizations, pursuant to art. 11 of law No. 366, October 3rd, 2001*”, has added the so-called “*corporate offences*” as set forth in art. 3 of the above mentioned Legislative Decree 61/02 and in art 25-ter of the Decree: *a)* Fraudulent corporate communications (art. 2621 Italian civil code); *b)* Fraudulent corporate communications to the detriment of shareholders or creditors; *c)* Misrepresentation in prospectus; *d)* Falsehoods in the reports or communication of independent auditors; *e)* Obstruction of control; *f)* Fictional formation of capital; *g)* Improper return of contributions; *h)* Illegal distribution of profit earnings and reserves; *i)* Illicit operations on the stock or shareholdings of the company or the parent company; *l)* Operations to the detriment of creditors; *m)* Improper division of the assets of the company by liquidators; *n)* Improper

As said before, the Decree prefigures, at article 6, a form of exemption from liability. In particular, this form of exemption scheme applies in cases where the entity can prove and demonstrate that an internal body has been vested with autonomous powers of initiative and control, and that it is able to supervise the functioning and enforcement of organization, management and control “models” suitable for preventing the perpetration of the specific criminal offences stated in the Decree. In other words, the control body has to set up, before any offence is committed, some sort of behavioural protocol in order to prevent and deter the commission of the offences listed in the Decree. Furthermore, two additional conditions that exempt the entity from the responsibility are that who committed the offence acted fraudulently, and that there was not any omission or insufficient control by the supervisory body.

The Decree also states that the above model must identify activities in which offences might be committed and envisage specific procedures for the implementation and planning of Entity’s decisions with regard to offences’ prevention. It also must introduce a private disciplinary system in order to charge penalties for failures of compliance with the measures introduced by the model.

The penalties envisaged for administrative irregularities caused by an offence are mainly pecuniary penalties, disqualification⁸, confiscation and publication of the sentence on newspaper circulating countrywide.

Entities are not held liable when they have voluntarily prevented the action from being committed or the event from taking place.

4. The need of a new tool.

As far as the target of the Decree is concerned, the sphere of application relates also both to holding companies and public economic entities. It is not clear if its

influence on the shareholders’ meeting; *o*) Insider dealing; *p*) Obstruction of the exercise of the functions of the public supervisory authorities. Finally, following the enactment and entry into force of Law No. 7 of January 14th, 2003, concerning the “*Ratification and execution of the international Convention for the repression of the financing of terrorism, drawn in New York on December 9th, 1999, and regulations for the alignment of internal laws*”, the so-called offences for the purposes of terrorism and subversion of the democratic order, envisaged by the penal code have been added to the list of offences pursuant the Decree 231/2001.

⁸ Specifically, the main disqualification penalties, which apply only to the offences pursuant to articles 24, 25 and 25-bis of the Decree, are: *a*) disqualification from exercise of the activity; *b*) suspension or revocation of authorizations, licenses or concessions relating to the offence committed; *c*) exclusion from grants, loans contributions and subsidies and revocation of any that might already have been granted; *d*) prohibition on publicizing goods or services.

applicability also includes other public entities of different nature providing services to the community, such as hospitals and universities.

As said before, one of the most important innovations is the introduction of “*organisation, management and control models*”, whose adoption by the relevant entity may provide, under given specific circumstances, an exemption from liability and consequently from monetary and/or disqualifying sanctions.

The architecture, preparation and implementation of these models by entities is of paramount importance, since the set of rules explicitly requires their compliance with basic principles already enlisted above, thus granting exemption only when: *a)* an internal Supervisory Body, adopted and effectively implemented before the offence is committed, is vested with autonomous powers of initiative and control to supervise the functioning and enforcement of the model and to keep it up-to-date; *b)* there was no omission or insufficient control by the Supervisory Body; *c)* the people who committed the offences acted fraudulently.

It is important to note that even if the adoption of the models and the simultaneous adoption of the Code of Ethics are not mandatory, it constitutes, over and beyond the requirements of law, an additional valid tool that raises the awareness of all employees of the company, and of all the other parties interacting with the company itself. Thus, the aim of this measure is directed to prevent and reduce risks of burden some monetary sanctions and safeguard company’s reputation.

Focusing on this last aspect it is worth to underline that, in terms of monetary sanctions the maximum sanction of 1,5 million of euros is given when the company’s profit obtained through fraudulent activities has been particularly considerable⁹. On the other side, the disqualifying penalties (from exercise of activity, suspension or revocation of authorizations, licences or concessions relating to the offence committed, contract prosecution with Public Administration, exclusion from grants, loans, contribution and subsidies and revocation of any that might already have been granted) may be prolonged up to a period of three years.

From an economic point of view, at the base of the “criminal” liability of legal entities there is the demand for the effectiveness of sanctions to be sentenced in case of an offence. For example, the sole monetary sanction towards a physical person

⁹ The Decree foresees the liability for the company when one of the listed offences has been perpetrated to the interest or advantage of the company itself by: *a)* natural persons in apical positions (representation, Administration or management of entities or other organizational units provided with financial or functional autonomy or persons who in effect exercise management and control); *b)* persons under the management or vigilance of one of the above mentioned individuals.

that committed an offence is often disproportionate either in respect to the “social damage” generated by the misconduct or the possible value or profit that the company obtained.

Another critical element is the risk of insolvency that may arise from a monetary sanction (proportional to the damage) to a physical person, as well as the problem of identifying the offender inside given the complexity of the company’s organisational structure; for example if we consider the cases of relevant function decentralisation and of the information as well, the problem of separating the single individual liability from the entity’s one becomes really hard. Thus, a sanction against a “legal entity” in addition to the one sentenced to the “legal person”, may induce the former to activate itself in order to control the activities of the latter.

Notwithstanding, whenever the damage is high, we may find this perpetrator insolvent. Thus, considering the entity as responsible may represent an effective mean of prevention. Furthermore, the sole detention punishment may have the inconvenience of highly raising the cost of sanctions, and to break the link between them and the damage, thus eliminating the indemnifying function.

The entities’ liability forces them to watch over employee’s behaviour generating a more effective deterrence against misconduct rather than the individual liability *per se*. Such an extension of liability has the merit of inducing the entity, which naturally acts as a maximizing economic agent, to “*internalize*” the externalities that originate from the illicit behaviour of its employee. The consequent result is that companies find it rational to adopt preventive measures in order to minimize, on one side, the damage inflicted to the firm originated by the behaviour of a single employee, and on the other side, the cost inflicted to the community.

Therefore, the company is forced to budget, within the costs of the production function, the costs of potential illicit behaviour of employees and to establish its own production level without shifting the production costs towards the community.

5. Formal economic analysis of the Legislative Decree.

The formal logic obeying the Legislative Decree 231/01 is based upon the build up of a bilateral incentive system which, in order to deter illicit behaviour, on one hand, aims to persuade companies to adopt adequate control measures, and, on the other, cuts down the inclination of a single person to commit certain offences. The aim of the model, anticipated by the Decree, is to force the firm to realize a simultaneous “double minimisation” of its private cost and of the social costs. As a matter of fact, the nature of such offences harms not only the community (e.g. consequences of a

bankruptcy in terms of loss of jobs or those relating to the safeguard of savings) but also the direct interests of the entity itself both in reputation and monetary terms. The Decree introduces a specific entity liability that naturally induces a comparison, in terms of economic efficiency, amongst various existing liability systems. For example, in a legal system of sole individual liability, the inclination to commit offences is directly related to the calculation of expected cost and benefit. In such a context a person will only consider his own costs and benefits, ignoring costs produced to the community as a result of his behaviour.

Observing fig. 5.1, we have on the X-axis the quantity of crime committed by an individual, while on the Y-axis the Marginal Revenue (MR), Marginal Social Cost (MSC) and Marginal Private Cost (MPC). The individual (producer of crime) maximizes his profit in (Q_p, C_p) where the MPC curve cuts the MR curve. Starting from the assumption that the goal of enforcement is to achieve that degree of compliance with the rule-prescribed behaviour that the society believes it can afford¹⁰, so that we can find an social “optimal” level of crime, it is evident that, in the individual maximization equilibrium point, the quantity of crime is above-optimal compared to the Q^* (desired or tolerated quantity of crime) where the social welfare is at its maximum. The difference between the C^* and the C_p gives us the measure of the negative externalities produced by the private agent.

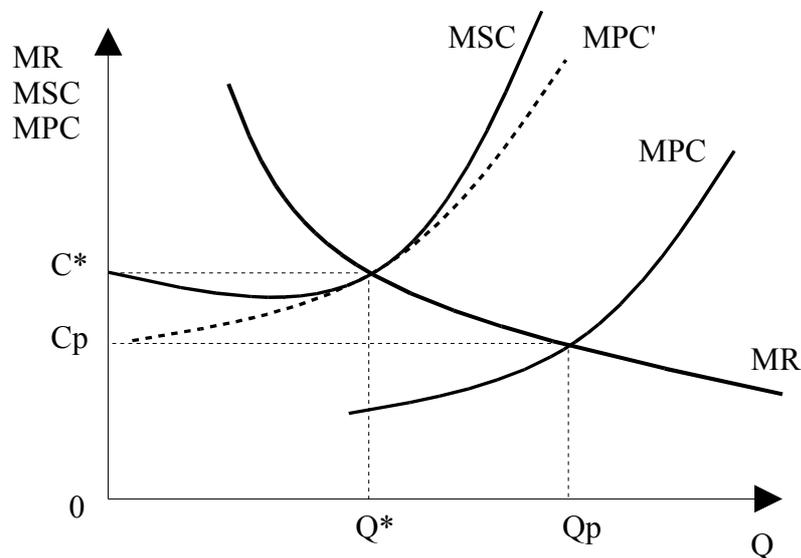


Figure 5.1: *Limits in a regime of individual liability due to spillover effects*¹¹

¹⁰ G. Stigler, *The Optimum Enforcement of Laws*, Journal of Political Economy, pp. 526-536, Vol. 19, N.4, May/June 1970.

¹¹ The private cost function, from which we derive the private marginal cost $dTC(q)/dq$, is a

Therefore, in such a liability system, exacerbation of sanctions is the main tool used to internalize the externalities generated from illicit behaviour: the application of a high cost sanction shifts the curve of private costs in MPC' and reduces the marginal inclination to crime towards the optimal Q^* . As a consequence, the incentive for a physical person to commit a crime is inversely related with the increase of the monetary sanctions.

The main limit of this liability system relies on the risk of insolvency. The consequent social damage is often higher than the individual economic capacity and, therefore, the social damage cannot be adequately repaid. The result is quantified as a deadweight loss for the community.

The economic analysis of Decree 231/2001 suggests that, in order to eliminate the inefficient internalization of social damage, in a regime of sole individual liability, it is necessary to shape a specific form of entity's social liability to place alongside individual liability.

As a result, the introduction of the entity's liability, for crimes perpetrated by the employees either in apical (representation, administration and management of entities or other organizational units) or in "inferior" position, is in line with the economic "ratio" of charging the firm for the cost of deterrence.

The enforcement of this form of liability shifts the core of decisional choices on the entity. As a matter of fact, the preparation and implementation of a control model (as already explained the adoption of such a model is not mandatory but left at the discretion of the entity) is entity's own choice.

The decision of adopting the model necessarily implies a careful evaluation of costs and benefits. The entity needs to calculate the cost of the model's adoption, which includes the preparation and implementation of an "ethic code", the educational costs and the cost of creating an *internal audit* body that supervises the effective application of the models.

Due to the high cost of preparing and implementing the model, the cost/benefit analysis calculation takes into account other variables such as the attitude of entities towards risk and the probability to incur in a sanction when a criminal offence committed is investigated and punished.

It is assertible that both variables are influenced by entity's dimension. A large company, with an elevated number of employees and high budgets, is not willing to

simple $TC=FC+VC$, where $FC+VC = e+op$ = effort in committing crime + opportunity cost of wages of other legal occupations.

take risks within the type of offences provided by the Decree. Thus, the bigger entities, the most large and successful ones, have rapidly adopted the organizational models suggested by the Decree, not being able to face a the risk of a loss of reputation (e.g. a corruption offence charged against its own administrator).

The choice to adopt the model, from a theoretic standpoint, originates from the awareness that its efficient implementation may discharge entities from responsibilities, if the model has efficiently been implemented, when an offence is first investigated. Thus, if the judge considers the entity's enforced "*level of attention*" in line with the criteria of efficiency envisaged by the Decree, she will sanction only the legal person who perpetrated the offence.

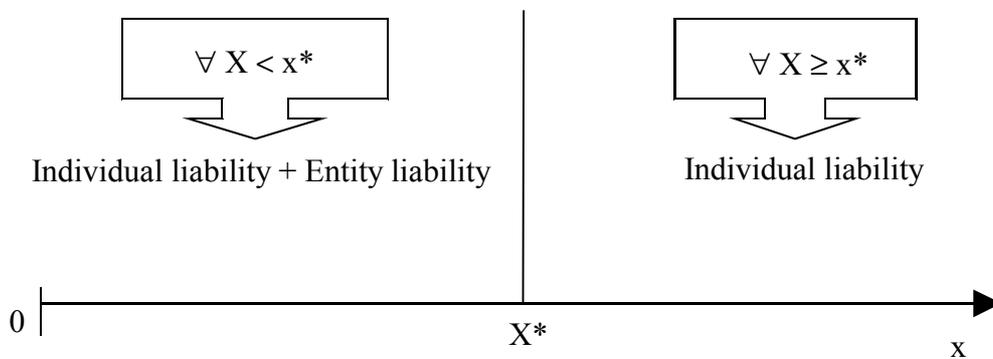


Figure 5.2: *The liability set due to the efficient adoption of the models.*

This process that leads to such a decision is not so different from the one that leads to the selection of the optimal "precaution" level that we find in the main models of "*tort law*" economic analysis: thus, we can suppose the existence of an x^* efficient level of precaution that can be adopted in order to avoid, *ex post*, a sanction. The entity's problem is to adopt a precaution measure $x \geq x^*$ (Fig. 5.2). Applying this formula to a specific case, we obtain that entities must adopt a precaution level in line with the Decree and suitable, *ex post*, to make entities exempt from liability for offences provided by the Decree itself and committed by fraudulently eluding the model¹².

All above considered, the first relevant observation, is that there is no exact

¹² From an *ex-post* perspective, we could consider X as a continuous random variable, whose values would correspond to different levels of accuracy of the model associated with a given probability. We could likely imagine the variable's probability density function as a Gaussian shaped one, in which the average would approximate the value who grants entity exemption from liability. According with this hypothesis, entities will unlikely adopt either a weak (and very cheap) model or a complex (and very costly) one, and will tend to adopt a model whose level of accuracy will be near to the optimum level.

definition of a minimal standard of “*precaution*” to grant the exemption from sanction.

For example, while in the typical road circulation the need to comply with speed limits or safety regulations is a very definite rule and doesn't imply difficulties to comply with it, in the case of entity liability it is hard to establish the borders of such complex and large rule.¹³

Let's suppose that the choice of the precaution model is given by the cure or precision of the model, and that a more accurate model determines a higher investment.

Looking at fig. 5.3, we can now imagine that, the entity will choose the adoption of a certain level of precaution x at a given unitary cost c . We may simply think that the adoption of a well-designed management model implies higher costs than the adoption of a rough one. This aspect is coherent with reality if we consider that there is not enough adequate background and/or a certainty on the requisites that the model must have in order to pass the ex post suitability test.

We then assume that the higher the resources are allocated, the higher will be its precision and, consequently, the probability to pass the suitability judgment. Assuming p as the probability that an offence could be committed and x the adopted precaution level, we can suppose that the said probability diminishes in response to the increase of x .

Thus, if the entity has adopted a well-designed model, the risk of potential offences will be reduced in the presence of an efficient level of control and as a result will deter model's elusion.

¹³ A first step in this direction has been done with the edition by *Confindustria* (Italian Industrial Association) of a paper titled “*Guidelines to build up organization, management and control of models ex Legislative Decree 231/2001*” where it emerges the first attempt to correctly interpret the Decree and model's preparation steps.

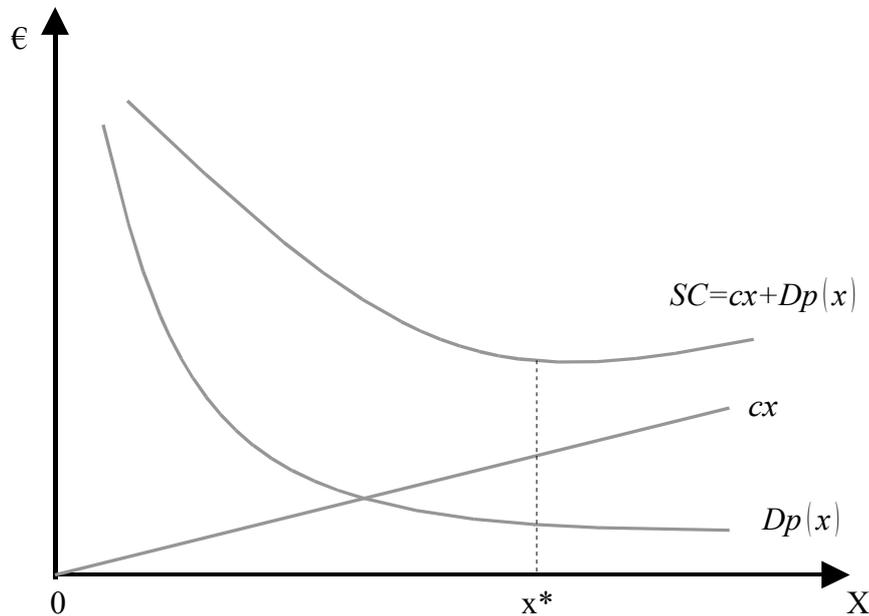


Figure 5.3: *Optimal level of deterrence.*

Going into the details, the probability “ p ” of committing an offence is linked to the level of precaution “ x ”, and the function $p = p(x)$ will be decreasing in x . As stated above, the perpetration of an offence implies damage “ D ”¹⁴ for the community as well as for the entity. “ D ” equates the monetary total amount of the damage. Therefore, the expected total damage will equal $Dp(x)$, which will still be a decreasing function at the increase of x . The costs derived from the offence¹⁵, pondered by the probability, are summed with the private costs relevant to the adoption of the model: the total provides a measure of the expected social cost from offences $SC = cx + Dp(x)$. The above equation generates a convex curve of expected social costs due to the offence.¹⁶

¹⁴ In this case we can assume that the damage “ D ” may be decomposed in 2 components D_1 and D_2 where D_1 is the social damage, that is the damage caused to the community by the offence (e.g. consequences in terms of employment, etc.) while D_2 is the “internal” damage, that is the loss directly charged on the entity (e.g. damage in terms of credibility following an investigation, profit losses, etc.)

¹⁵ Hypothetical costs that may be split up in two components: the derived monetary cost for the community (e.g. jobs’ level, etc) and the cost in terms of loss of credibility resulting in negative advertising for the entity. Thus, the damage for the entity that originates from an offence is not only of a social nature but also private, that is charged either directly or indirectly on the entity itself.

¹⁶ In correspondence to the efficient precaution level x^* , the marginal cost of precaution equates the marginal benefit, that is a reduction in the expected damage for the entity. Levels of $x > x^*$ results in an excess of expenditure in terms of precaution rather than to efficient

The optimal precaution level is obtained when the entity no longer finds convenient to raise the level of precision of the model because further increments do not produce an equivalent reduction of the probability that an offence could be perpetrated.

This type of tool may be applicable in our case, however it is important to highlight some significant differences that should be taken into account. In particular, it is useful to remember that the maximizing calculation is, in this case, carried out by an entity and not by an individual, thus the entity's choices and strategies are complex and carefully studied. Moreover, in such a context, the minimum standard of precaution, which grants exemption from liability to the entity, is not specified. In the case of the entity's administrative liability a huge problem emerges due to the incorrect definition of standards necessary in order to arrange in advance an adequate model. The absence of "strict" parameters for the enforcement of the models is mainly due to the lack of a relevant number of cases debated and sentenced in force of the Legislative Decree 231/2001. Furthermore, as we will see later, two recent cases did not give any help in solving and clarifying this crucial issue.

6. Closing remarks.

The Legislative Decree No. 231 dated 8th June 2001, marks a turning point in preventing and sanctioning corporate offences in the Italian national framework, introducing a specific administrative liability for the entities.

Due to this new set of rules, entities may be held liable and consequently sanctioned when employees in apical or "inferior" position commit, or attempt to, offences in the interest or advantage of the entity.

The core innovation of the Decree consists in the provision of specific forms of exemption from entity's liability which, promoting models of *self-regulation* (and *self-enforcement*), has a series of interesting consequences.

The analysis related to the effects of the enforcement of the new regime of liability has highlighted the following critical aspects: the first point is related to the effective interpretation and understanding of the guiding principles of the rule. In particular, the main problem is to identify the boundaries and the range of the management models as a means of deterring offences and granting liability exemption to the entities.

level and vice versa. In the classic model of *tort law* (see above all R. Cooter, T. Ulen "*Law & Economics*", 2004) there are non-particular assumptions regarding the nature of precaution. The measure of the adoption of precaution is often enforced either by the victim and the perpetrator of the offence; some other times it is unilateral. In our case the entity is the sole actor adopting precautionary measures.

In other words, when analyzing the new legal tool it becomes evident that, despite the effort made by the Legislator to clarify and get the Decree measures easily enforceable, the exact specification of the nature and structure of the organizational, management and control models is a complex and wide subject. As a consequence, it seems that the main source of uncertainty arises from the type of procedure and the degree of precision of the control activity. Above all, the suitable level of “precision” in the adoption of such models remains unknown. In point of fact, from the examination of judicial cases emerges that the mere adoption of the code of ethics was not sufficient to exempt the entity from liability when an offence was prosecuted.

A second relevant consideration concerns the identification of the control body. For this issue, the focus is on the trade-off between the nature of the agent in charge of the control and the quality/operability of this control. It may appear appropriate and more useful, in order to achieve a better degree of precision, to provide a qualified outsourcing body with the responsibility of controlling the adoption and compliance of the organizational models.

However, it is for some extent disappointing that this solution is not in line with the Decrees’ framework. In fact, the Decree prescribes that a specific internal body should carry out these functions. Furthermore, this solution seems to underestimate the risk of a less effective and precise control, due to the identity between the controller and the individuals subject to the control. This kind of problem is particularly true for the medium and small entities. In such a context, besides the objective difficulty of preparing suitable, rather expensive models, we find that the internal audit committee is mainly made up of persons in apical positions within the entity; paradoxically by the same individuals that are directly involved with the rule and that are, at the same time, the potential perpetrators of such offences.

Another important issue connected to the Decree is given by the circumstance that there is no valid legal background on the matter. Undoubtedly, the difficulty of structuring a suitable model is strictly connected to three principal factors: *i)* the uncertainty about the “*ex-post*” control procedure of the model; *ii)* the quality and the structure of the agents responsible of this function; *iii)* the proper qualification of the controllers to carry out such a task.

It is questionable whether a judge has the capability or the sufficient (technical) knowledge, to evaluate the suitability and the effective deterrence of a given management model. The doubts arise from the consideration that the judge is a third external subject to the entity in an evident position of asymmetric information.

In this respect, significant assistance will come exclusively from a consistent, specific jurisprudence. This will promote the creation of a background, which will be an important reference parameter for entities.

Two recent cases have determined awareness on the one hand, for the real innovative range of the rule, and on the other, for the serious consequences that the rule may have on the firms.

The first case¹⁷ involved two managers of the German firm Siemens AG regarding a bribe paid to two administrators of ENEL and ENELPOWER firms in order to promote the selling of gas turbines to the same firms. Following the investigation of the relevant criminal offence, the judge sentenced Siemens A.G., in force of the Legislative Decree 231/2001, with a one-year interdiction from contract prosecution with the Public Administration.

In this case the judge punished the entity with an interdiction sanction, although the entity had reimbursed the victim of the corruption attempt, with 180 million euros. This sanction originated from the judge's belief that Siemens did not adopt a real organizational model but only a simple code of ethics proven to be completely ineffective. Furthermore, it was also evident that the entity, after the prosecution had begun, did not react properly (for example through the implementation of models that, even though late, could eliminate the shortfalls) by providing precise answers to assert their willingness to adopt a new organizational model able to deter such offences and identify the existent areas of risk.

However, not much later the Tribunal of Milan carried out another prosecution that involved the application of the Legislative Decree 231/2001. This time four firms, active in the health-care field, negotiated a sentence involving only a monetary sanction. In this case the entities escaped the interdiction sanction because, after refunding the damage, they demonstrated their immediate intention to eliminate the organizational shortfalls facilitating the offences.

As we can see, these are situations where the same type of offence had a different epilogue due to the different behaviour of the entities. Thus, the application of the rule certainly appears to be quite discretionary given that the so-called "market damage" has to be taken into account in terms of the direct consequences of the firms' behaviour, especially on competition.

Furthermore, it is evident that the application of the interdicting measure to Siemens is designed to seriously affect the entity in two ways. From one side, by

¹⁷ Tribunal of Milan – Italy, ordinance n° 2460/03 R.G.N.R., april 27th 2004.

making it impossible to contract with the Public Administration, and from the other, hindering their reputation.

At last we can underline that, the key point of the law, considering the profit maximization behaviour of the firms, is the possibility to avoid sanctions through the adoption of systematic methodologies of control. The Italian firms representative organization (Confindustria), has been aware of this for a long time, and has made pressure on firms in order to enforce control models able to protect firms' reputation and profits.

In line with the Decree, it is entities' decision to set up the model either internally or by applying outsourcing resources. This is an essential issue because, as observed in the Siemens case, the lack of adopted models allowed the judge, with huge discretion, to sentence a measure that significantly affected the firm's economic situation.

All above considered, we deem it appropriate to revisit the Law, not for its ratio, which everybody agrees upon, but for its concrete modality of application, in order to avoid irreparable consequences for the entities that are unable to cope with heavy measures.

In our opinion, the analysis of the Decree implies two final considerations: first, the most evident element of the rule pertains with the introduction of a new form of liability, placed alongside the individual liability, which contributes in rectifying some inefficiencies of the latter regime. If the main target of firm liability is reducing the potential offences through the implementation of management models, it may also produce the elimination or restraint of the risk of insolvency typical of individual liability regimes. This kind of risk is relevant to the type of offences contemplated by the Decree.

Secondly, the most interesting aspect, which is relatively less argued, attains the regime of incentives that the rule has provided. In particular, sticking to the main tool of implementation of the new regime of liability, several interesting considerations emerge.

We have already seen that the adoption of models, which enforce the necessary measures to avoid expensive sanctions, is not compulsory. This implies that the firm faces a dilemma on whether to choose the adoption of management models, which consequently opens up room for "adverse selection".

Given that this selection implies high costs, what will be the key factor which will force the entity towards one direction instead of the other? We need to underline

how the choice of a large dimension firm of is almost compelled. The decision to adopt the models is an indispensable requirement attaining credibility demand, more visibility on the market and tutelage (see Siemens case) from costly measures and consequent high economic damages. In addition, large entities often already have some sort of body in charge as *internal auditor*, thus they don't need huge investments in this area. Conversely, for small and medium firms the choice of the model may imply rather high investments and the need to enrol an external entity in order to map the risks, lay down the ethic code and carry out activities related to employees' formation.

Is it then feasible to argue that the decision of the entity *does not* depend on a strategic behaviour based on the probability that the offence may be disclosed and sanctioned *ex post*? Therefore, the presumed calculation of costs and benefits, prior to the adoption of the models, has to take into account the probability that some offences, e.g. of minor consistency or of difficult detection, may remain unpunished. Furthermore, we wonder if and how the system of incentives introduced by the Decree actually makes public and private interests to coincide, and if the adoption of means, such as the ethic code, may go over the "*conformity*" with the Decree becoming a real code of values for the firm itself.

This last aspect is quite significant if we also take into account the implications, in terms of incentives for *self-regulation*, deeply rooted in the Decree. The system, foreseeing the adoption of non-compulsory prevention measures, shifts the burden of adopting the model directly towards the firm. This reasoning could lead to that already experienced in matters related to accidents on work sites, where entities find it more convenient to apply all the necessary tools in order to avoid more onerous sanction, such as the disqualification and consequent cessation of any activity. In this case, it seems that the decision of adopting precautions depends on the strength of the sanction. The latter cannot be avoided if the accident occurs and the firm had not at the time adopted sufficient safety measures. The principal difference with the regime established by the Decree is the "*ex post*" uncertainty arising from the detection and the evaluation criteria of the precaution measures. As a result, the firm's incentive to adopt may be radically modified.

In conclusion, where the adherence to a certain standard becomes an important signal for the market, the result is a further incentive towards the full acceptance of the Decree provisions, which partially rebalances, in the firm's calculation of costs and benefits, the impact of the detection probability variable.

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