

# Crime and Criminal Behavior

## Corporate Crime

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## Chapter 5: Corporate Crime

Corporate crime is criminal activity committed by organizations meant to profit the organization. An understanding of corporate crime often requires learning the language of business and conceiving of both crime and victimization in a collective and aggregate sense. Corporate crime has existed as long as there have been corporations, but history shows that more recent corporate crimes have been more extensive and have resulted in greater losses to victims than in years past. There are several different kinds of corporate crimes, and each of these results in different kinds of harm or costs.

Typically, crime information in a local newspaper was contained in the front and middle sections, which provides local crime information as well as news and advertisements. More and more often, however, crime information is found in the business section. The following example begins to answer the question of why crime news has made that shift.

### The Galleon Group

A hedge fund is an investment company that is allowed to use aggressive strategies to gain wealth for its members that are unavailable to mutual funds, which are more closely regulated. Such funds are limited to no more than 100 investors, so the minimum investment is typically high, anywhere from [p. 60 ↓ ] \$250,000 to over \$1 million. Investors pay a management fee to the hedge fund and the fund itself collects a percentage (usually 20 percent) of the profits.

Ray Rajaratnam was the leader of a hedge fund called the Galleon Group, which managed over \$3.7 billion in assets that were invested in various companies and financial instruments, all with an eye toward making a profit for the investors. But on October 16, 2009, Rajaratnam was arrested at his home and charged with running the largest-ever insider trading scheme involving a hedge fund.

Terminology is typically an issue with corporate crime because the language of everyday life is not sufficient to describe the business world. Insider trading involves using information that is not available to everyone, and is restricted to only a few insiders. Companies are required to publically disclose important news, like quarterly earnings, at the same time. If an insider uncovers such news earlier than the public, even an hour earlier, that is considered insider trading. Alex Berenson of the *New York Times* wrote in 2009 that the most precious commodity on Wall Street is information, because buying and selling depends on knowing what to invest in and what not to invest in.

The Galleon Group used a number of tactics to obtain that information, including trading tips for money, other tips, and sometimes the promise of unspecified future favors. And not every trade is profitable. For example, the Galleon Group lost millions of dollars investing in Advanced Micro Devices (AMD), a computer chip company, after they followed the government of Abu Dhabi in investing in AMD. However, AMD stock plummeted shortly after Galleon made its investment.

Nevertheless, Galleon Group made a significant profit over several years from the information obtained by Rajaratnam, and eventually, the Securities and Exchange Commission discovered that such information came from insiders.

## The Nature of Corporate Crime

Corporate crime is one form of occupational crime, which is crime that is committed during the course of one's legitimate occupation. Researchers distinguish blue-collar from white-collar crime by the kind and status of the occupation in which the crime occurs. Blue-collar crime can include theft from one's place of work, such as an automobile mechanic who steals tools from the garage where he works. Blue-collar crime looks like conventional crime because it mainly involves theft.

**[p. 61 ↓ ]** White-collar crime can include defrauding investors, such through a Ponzi scheme, a fraudulent investment operation that pays returns to individual investors from their own money or money from other investors, rather than from any actual profit. The scheme is named for Charles Ponzi, a mastermind who became famous for generating

large volumes of money by using the technique in the early 1920s. In 2009, Bernard Madoff was charged with operating the largest-known Ponzi scheme to date, which bilked investors of \$65 billion. Because he was an otherwise trusted investor, he was able to abuse his position for personal gain.

As with white-collar crime, corporate crime involves an abuse of power. By their nature, corporate crimes involve wrongdoing by powerful and usually wealthy organizations. The term *corporate crime* is usually associated only with business organizations, but other organizations, such as political parties, can also commit corporate-like offenses that involve an abuse of power. For that reason, the term *organizational crime* is probably more accurate to describe abuses of power by political or other groups.

As part of understanding corporate crime, one must understand the term *argot*, which is specialized language used by people in different occupations. Like the example of the Galleon Group, terms such as *hedge fund* and *insider trading* must be known to fully understand the nature of the offense. Add to the vernacular such expressions as *selling short*, *leverage*, *program trading*, *swaps*, *arbitrage*, and *derivatives*, and just the descriptive terminology becomes more complicated.

Corporate crime must also be considered as group behavior, although represented by individuals. When Enron went bankrupt in 2001, certain individuals were involved in the specific illegal conduct for which they were charged in criminal court, such as the chief executive officer (CEO), Kenneth Lay. But the company's stock plummeted as a whole, leaving current and former employees without current or retirement income. Corporations are not individuals, but the notion of corporate crime requires a perception of the corporation as an actor.

Victimization, too, must be considered in collective terms. A consumer might be charged an extra few cents for breakfast cereal due to an illegal price-fixing conspiracy by a corporation, but those few cents from many customers add up to large profits. So, while any given cereal buyer is not victimized out of a large sum, taking in many customers in this manner can result in significant illegal profits for the cereal manufacturers.

Criminologist Frank Hartung's definition of corporate crime is that corporate crime is a violation of law regulating business that is committed for [p. 62 ↓ ] the firm, by the

firm, or its agents in the conduct of its business. While Hartung's definition focuses on economic organizations, the definition is equally applicable to other organizations, such as political parties.

## The Development of Corporate Crime

Throughout U.S. history, there has been concern over the actions of high-placed individuals. This concern intensified in the 1880s and 1890s, as investigative journalists (called *muckrakers*) were particularly interested in the behavior of business leaders. There was good reason for this. Muckrakers were concerned that big business and other powerful people were neglecting their social responsibilities.

During the last part of the 19th century, the development and spread of business was encouraged in a growing economy. By the end of that century, however, the threat of monopolization seemed to be overcoming the fierce competition that was seen as the essence of capitalism. There was strong concern at the time over the oil, railroad, and manufacturing industries in this regard.

It became apparent that some regulation was required to prevent monopolies from forming. These regulations were largely placed in civil and administrative, and not criminal, codes. One example was the Sherman Antitrust Act of 1890. The term *trust* is a bit archaic now, but at the time, it meant one company using another to gain a competitive advantage. The purpose of the act was not meant to protect competitors from one another, but to protect the very idea of competition.

The difference between administration and regulatory law and criminal law is important. The purpose of criminal law is the demonstration of liability (guilt) and punishment for wrongdoing. Each type of law administers different penalties. While each body of law can levy fines, imprisonment is possible only under criminal law, not administrative law.

The purpose of administrative law is to obtain compliance with the law—such as an injunction, which is merely an order to stop doing something, like restraining trade, polluting a body of water, or creating a monopoly. Compliance is exercised through

regulatory agencies, such as the Federal Trade Commission (FTC), Federal Aviation Administration (FAA), and Securities and Exchange Commission (SEC).

The development of regulatory agencies and the expansion of corporations in the United States went hand in hand. As corporations grew larger and more numerous, so did the number of their violations in the 20th century. [p. 63 ↓ ] By the end of that century, the economic landscape of the United States was populated heavily by corporations, in which citizens entrusted their health (health maintenance organizations and the pharmaceutical industry), wealth (banks and investment firms), and their safety (automotive industry and other manufacturing).

The criminological pioneer in studying corporate crime was Edwin Sutherland, whose research in the 1940s examined the legal environment surrounding the 70 largest corporations in the United States. Sutherland used the term *white-collar crime* to denote the illegal behavior that he found interesting.

## Corporate Crime in the 21st Century

The extent of corporate crime was most keenly felt in the first decade of the 21st century, when the stakes seemed to grow exponentially. In 2001, Enron, a very large energy company headquartered first in Omaha and then in Houston, disclosed that it was in financial trouble. Once the world's largest energy trader, Enron filed for the largest-ever U.S. bankruptcy amid an investigation surrounding off-the-book partnerships used to deflate debt and inflate profits. Enron's board of directors also allowed management to engage in high-risk business practices and gave the executives free rein. Members of the board allowed Enron to move nearly half of its assets off the balance sheet to make the company's financial statements look better, an action that was facilitated by the accounting firm of Arthur Andersen, which collaborated to inflate Enron's stock price to trick investors. The scheme involved both hiding liabilities and mixing sales with earnings.

When discovered, employees of Arthur Anderson tried to minimize their involvement by shredding critical documents. Such action prompted a Justice Department probe and

the filing of criminal charges. Arthur Andersen was convicted of obstructing justice, and the company agreed to surrender its licenses and its right to practice before the SEC.

The Enron case was notable beyond the damage it caused, and that damage was sizeable. Thousands of employees lost their jobs, and thousands of retired Enron employees lost their retirement funds because it was tied to the value of the company's stock. But beyond the financial loss, the Enron scandal signaled a new way of thinking about and interacting with large companies. In part, this was due to the illegal actions of other large corporations that followed the collapse of Enron.

**[p. 64 ↓ ]** In late 2001, television and magazine celebrity Martha Stewart sold nearly 4,000 shares of ImClone, the day before the FDA rejected the biotech firm's application to market a new cancer drug. Stewart was close to ImClone CEO Sam Waksal, who was subsequently arrested for insider trading. He was accused of trying to sell his shares of the company stock and urging family members to do the same after he learned that the FDA would reject the drug. Waksal and Stewart, as well as Stewart's broker at Merrill Lynch, Peter Bacanovic, all received prison terms.

The following year, WorldCom, the nation's second-largest long distance telephone provider, disclosed that it had improperly accounted for \$3.9 billion in costs. The technique they used, called *capitalized costs*, is an old one, and results in a much rosier balance sheet. First, the company pays costs, but the costs are not included on the income statement, making the company's net income appear higher. Instead, the costs are put on the company's balance sheet—which is different from an income statement—as an asset. Companies are only supposed to do this when they buy equipment that will be used over a long period of time. The company finally depreciates the costs by deducting them from the income over a period of time rather than all at once, even though the money for the costs is completely gone. On the income statement, only a small amount of the costs are included in any given year, so that cash flow, profit margins, and net income—key indicators of a stock's value—are artificially inflated. A similar technique had been used in the Enron case.

Prior to WorldCom's stock plummeting, however, former executives of the corporation sold most of their shares while the price was still high, because they knew the stock price was artificially inflated. One result of this was a class-action lawsuit against

WorldCom and its executives for failing to manage the company's 401(k) plan in the best interest of the participants, and using insider information to the detriment of other employees.

These weren't the only companies that experienced problems around this time. Improper dealings, accounting scandals, and questionable and illegal business practices also effected telecommunications giant Global Crossing; energy company Dynegy; Tyco International, an international manufacturer and servicer of electronic and underseas communications equipment; cable company Adelphia; and drugstore chain Rite Aid.

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## Types of Corporate Crime

Corporate crimes can be distinguished based on the victims of the crime.

### Crimes Against Consumers

These offenses include the manufacture and sale of faulty products such as toys that break too easily, cars that turn out to be “lemons,” and drugs that are marketed with too little or no testing. Some poorly manufactured products may not only result in an inconvenience for consumers, but can also cause physical harm. The sale of dangerous toys has included products with high levels of lead in paint, or with detachable parts that can be ingested by children. Lead in high levels can cause comas, brain swelling, and convulsions. In some cases, lead poisoning can lead to death. Other recalls include a national, brand-name backpack leaf blower that was withdrawn from the market because the fuel containers were reported to break, spilling gasoline and creating a fire hazard. Some baby hammocks were recalled when it was discovered that the hammock could flip over, posing a serious fall hazard and strangulation hazard to infants who become entrapped in the seat's restraint straps while upside down.



While some of these examples were not intentionally manufactured incorrectly, there are plenty of examples of corporations cutting corners to increase their profit. Major historical examples include the Corvair automobile by General Motors, and the Pinto by Ford Motor Company. In each case, engineering and manufacturing defects led to serious injuries and deaths. These are not isolated incidents. Even quality-conscious Toyota recalled nearly four million cars in 2009 for a possible defect that could interfere with movement of the accelerator.

## Crimes Against Owners

Many corporations are owned not by their management team, but by their stockholders, individuals whose stock value depends on the financial health and vitality of the corporation. In many instances, it is the management team of the corporation who deliberately misleads investors, and potential investors, about the financial status of the corporation. Such violations include creating deliberately false financial statements that deprive potential investors of important information on which to make their investment decision.

The Enron bankruptcy is an example of this type of corporate crime. Enron, with the assistance of a large accounting firm, misled current and potential stockholders about the actual financial status of the company to encourage more stock purchases. Various creative accounting measures helped to convey an incorrect picture of the financial health of the corporation.

**[p. 66 ↓ ]** When the fraud was uncovered and the corporation went into bankruptcy, thousands of people lost their jobs and thousands of others lost their retirement because it was tied to the value of Enron stock.

## Crimes Against Employees

A corporate crime against employees would involve a deliberate violation of occupational health and safety rules motivated by financial benefits. Failures to provide employees with appropriate safety equipment or exposing them to harmful working

conditions are examples of this kind of corporate crime. It is now known that exposure to asbestos fibers eventually leads to serious lung diseases and death. Workers in shipyards, where asbestos was a principal raw material in the construction of ships, were exposed to this harm for extended periods. Many died before it was known that workers should take precautions. If an employer knowingly permits employees to expose themselves to such dangers, such an act is illegal. For example, a mine explosion that trapped 12 miners in Sago, West Virginia, in 2006 left only one survivor. The precise cause of the explosion is still not known, but the federal Mine Safety and Health Administration had cited the Sago mine owners 208 times for safety violations in the previous year alone.

Most corporate crimes victimizing workers involve injuries, exploitation, or simply job dismissal. Many labor laws are designed to reduce unfair treatment of employees. For example, the company that owns Jack-in-the-Box restaurants in California was fined for nearly 400 child labor law violations. These violations involved teenagers working more hours than permitted by law. Direct injuries can also occur from more serious violations, such as when Union Carbide Corporation employees were required to detect the presence of deadly gas by sniffing the air, without respirators, after an alarm indicated a leak. Union Carbide was fined \$1.37 million by the Occupational Safety and Health Administration (OSHA) for hundreds of violations in its West Virginia plant.

## Crimes against the Public at Large

Everyone is at risk when breathing air or drinking water that has been polluted in the course of manufacturing. When a company continues to pollute in violation of Environmental Protection Agency (EPA) standards and rules, it violates its position of trust and power for its own gain. For some companies, a decision not to pollute is an expensive one; antipollution [p. 67 ↓] equipment may be expensive, and if that equipment is not available, the company may have to retool or go out of business to avoid violating pollution laws. Thus, the costs of complying may simply outweigh the benefits. The effect on victims is not clear-cut either. Residents of a small town with a polluting paper mill, for example, may be victimized by large amounts of particulates in the air. But complaints to the mill or to the EPA may cost jobs to the detriment of the town.

Corporate offenses aimed at the government also involve victimizing the public at large, usually through large, expensive government programs that are supported by tax dollars. Medical corporations that defraud Medicare or Medicaid are example of this kind of crime. Ultimately, the taxpayer is the victim if government funds are involved.

## Costs of Corporate Crime

It has become clearer in the 21st century that corporate crimes harm society in a number of measurable and immeasurable ways. The U.S. Department of Justice does not maintain statistics on corporate crime like it does on conventional or street crime. As a result, there is disagreement on the prevalence of corporate crime and how much of it is prosecuted either in administrative or criminal courts. The inability to track corporate crime also has implications for estimating the costs of these crimes.

## Financial Costs

It is not possible to provide a clear estimate of the financial impact of corporate crimes, but estimates run in the trillions of dollars. The Enron collapse cost the public billions, and Enron was only one case. To cite another single case, Exxon Oil Company ran up \$2 billion in illegal gasoline overcharges from 1974 to 1981. Combining the total financial burden from all such scandals would generate astronomical figures.

Perhaps the most comprehensive estimates are those presented by researchers at the National White Collar Crime Center, which estimates both individual, white-collar crime and corporate criminality. Using an exclusive definition and providing a range of estimates, these investigators estimate that white-collar and corporate crime costs between \$425 billion and \$1.7 trillion per year. Such figures are staggering, but researchers are only just beginning to zero in on sound estimates for the financial costs of this form of criminality.

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## Physical Costs

As high as these financial estimates are, by most standards, they do not include the total losses that accrue from abuses of power. For example, these financial estimates do not cover the losses due to sickness and even death that result from the environmental pollution of the air and water; the sale of unsafe food and drugs; defective autos, tires, and appliances; and of hazardous clothing and other products. They also do not cover the numerous disabilities that result from injuries to plant workers, including contamination by chemicals that could have been used with more adequate safeguards; and the potentially dangerous effects of work-related exposures that can result in malignancies, lung diseases, nutritional problems, and even addiction to legal drugs and alcohol.

To put it slightly more dramatically, corporate crimes do not just cause financial harm—they can result in injuries or even death. Children have been killed through the manufacture of faulty cribs or dressers because there is more profit in cutting corners. Children have died after exposure to toys constructed in other countries that use a great deal of lead in the paint put on the toy. Adults too, of course, can be harmed or killed as a result of purchasing faulty products.

The General Motors Corvair and the Ford Pinto are two glaring examples of faulty products that have killed consumers and bystanders. It would be inaccurate to claim that the executives at General Motors and Ford Motor Company were deliberately attempting to kill the drivers of their cars, but their allowance of faulty designs had that effect.

## Social Costs

Few dispute the high physical and financial costs associated with corporate crime, but the type of harm most stressed by sociologists is harm to social relationships and trust. In his initial research, Sutherland recognized that white-collar and corporate crimes violate trust and, therefore, create distrust. This, in turn, lowers morale and produces social disorganization.

Modern industrial societies are complex, and have a very sophisticated division of labor to deal with this complexity. It is simply not possible for every modern individual to be aware of every fact necessary for survival. So, when faced with life's challenges and problems, individuals must trust that other experts will be able to fairly solve them. If injured, individuals must turn to physicians; for a broken television, a TV repair person is consulted. To facilitate this exchange, a sense of trust in the integrity of the [p. 69 ↓ ] physician and mechanic is necessary. This sense of trust placed on others in times of need is this trust that is at risk with respect to white-collar and corporate crime.

The negative impact of some abuses of power on interpersonal trust assumes that (1) high-status persons serve as moral role models for the rest of the population, who, in turn, pattern their behavior after those they emulate; and (2) the public generally views abuses of power as relatively serious, at least compared with street crime. While these assumptions may be questionable for certain abuses of power, consumers who feel they have been cheated by a merchant are certainly less likely to shop there again and, perhaps, more likely to regard other merchants suspiciously. Similarly, if one has been overcharged for car repairs or for repairs that were never done, it is possible to develop an attitude that "all mechanics are crooked," even if one's sample of business relationships with car mechanics is limited.

## Pro: Applying Criminal Law to Corporate Crime

Traditionally, corporate crimes have been defined in administrative law and in the decisions of regulatory agencies. Often, specialized enforcement agencies have to be used because of the complexity of these crimes. Yet, there is a strong belief that criminal, rather than administrative, law should be employed to combat corporate crime. The use of criminal law has advantages over administrative regulations.

One advantage of using criminal law is that criminal sanctions, which are more severe than administrative sanctions, can be used. Imprisonment, for example, is an option only under criminal law. This could have a significant effect with respect to these crimes because the legal system has a better chance to deter corporate criminality. These

crimes are not impulsive; rather, they are planned, often far in advance, by rational actors whose behavior could be influenced by criminal sanctions.

## Con: Against Criminal Sanctions for Corporate Crime

One argument against the use of criminal sanctions is that conviction requires a much higher legal standard (beyond a reasonable doubt) than a civil decision (preponderance of evidence). A criminal standard assumes approximately a 98 percent certainty by the judge or jury, but a civil standard is much lower. Given this difference, judgments against corporations would be more likely even if the available sanctions did not include imprisonment.

**[p. 70 ↓ ]** Most corporate crimes are extremely sophisticated, and responsibility in organizations for such offenses is often very diffuse. For example, while Kenneth Lay, the CEO of Enron Corporation, was convicted of 10 counts of securities fraud and related charges, there were other executives in that firm that had as much or more responsibility for the fraud, but who were not prosecuted. If the decision was made to seek civil judgment, those individuals could have been brought into the system and sanctioned, although they would not have received a prison sentence, like Lay.

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## Further Readings

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