SCANDAL AND REFORM: AN EXAMINATION OF SOCIETAL RESPONSES TO MAJOR FINANCIAL AND CORPORATE CRIME

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Scholars have long been interested in the study of corporate crime. The current financial crisis caused by widespread defaults on sub-prime mortgages brings a renewed call for understanding the significant harms produced by reckless corporate practices. This thesis utilizes a multiple case study approach to examine four major corporate scandals throughout American history. These cases include Cooke & Co. and Northern Pacific Railroad in the 1870s, the Insull Utility Holding Companies in the 1930s, the Savings and Loan Industry in the 1980s, and Enron in the early 2000s. A macro-social adaptation of Sherman’s (1978) examination of corrupt police organizations is used as a logical model to analyze the cases using cross-case synthesis. The four cases are compared using the framework to uncover common patterns of reactions to major corporate crimes. The thesis concludes with a discussion of various policy alternatives for handling complex corporate crime problems, including a guide for future research.
To my wonderful wife, Katie.
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CHAPTER I.
INTRODUCTION

The goal of this research is to examine the systemic forces involved in major corporate and financial crimes, similar to the recent fraud that has become a symbolic characteristic of the mortgage industry. The entire makeup of the global financial market changed during a two-week period in fall of 2008. Investment banks collapsed, credit stopped flowing, and the Congress passed a $700 billion Troubled Asset Relief Program (TARP) to prevent further bank failures (“Credit Crisis,” 2009). The situation quickly turned into the largest bank failure in history and sent the entire world into a financial downturn that continued into 2009 and 2010. Fraudulent activities on multiple levels of the mortgage industry were a major contributing factor to the issuance and securitization of sub-prime loans that eventually led to millions of foreclosures (Fulmer, 2009; Liederbach, 2010). Both government and private financial institutions failed to assess the potential consequences of their decisions, resulting in organizational deviance, and producing widespread social harm (Liederbach, 2010).

The complicated process of packaging mortgages in bundles to be sold as securities created a system of conflicts of interests, providing virtually unlimited opportunities for fraud in the mortgage industry (Kumpan, 2009). The collapse of the housing market left the public wondering why this large-scale financial fraud had occurred and whether a scandal of this magnitude had ever been experienced before. In reality, corporate and political scandals have been consistent throughout history, causing immeasurable levels of harm to society (Markham, 2006). The sub-prime mortgage default crisis is merely the latest installment in a series of abuses perpetrated by offenders with a seemingly legitimate face.
Corporate crime is a consistent problem not given adequate attention by academics, practitioners, and policymakers compared to less damaging street crimes (Geis, 2007). The structure of corporations and the securities market creates opportunities for crime and organizational deviance. This can eventually lead to a corporate scandal causing substantial societal harm. Subsequent reform efforts fail to mitigate the damage caused by the scandals due to the inadequacy of reforms. This thesis proposes that by conducting a multiple case study through the replication of four different cases of corporate crime scandals, a pattern of scandal and reform will be illuminated. These four financial crime scandals will be analyzed using an adaptation of Sherman’s (1978) conceptual framework of the cycle of scandal and reform in corrupt police organizations. These cases include: 1) Cooke & Co. and Northern Pacific Railroad, 2) Insull Utility Holding Companies, 3) the Savings and Loan Industry, and 4) Enron.

The Cases: An Overview

The first case is the 1873 collapse of Jay Cooke & Co., which contributed to a near decade-long recession. The 1800s railroad industry represented the first large American corporations. Many railroads were funded primarily through the sale of securities to investors from all socioeconomic backgrounds. Cooke & Co. sold securities in the Northern Pacific Railroad to individual investors through a door-to-door marketing campaign (Lubetkin, 2006). Cooke took on more debt than could be paid back to investors and was unable to follow through on unrealistic financial projections. Cooke & Co. collapsed and millions of mostly middle and lower class investors lost their money, creating panic on Wall Street (“The Panic,” 1873). This was one of the first major corporate crime cases in American history, caused by the careless actions of a railroad company that put immediate profit before long-term economic health.
Although crime was prominent in the entire railroad industry at the time, the case of Jay Cooke was one of the most significant corporate crimes of the latter half of the 1800s.

The second case again involved the misuse of securities, but instead introduces a more complicated structure of corporate financing used for the expansion of utility companies. Samuel Insull developed an innovative strategy for power distribution in Chicago in the early 1900s. He grew a small utility company into one of the largest utility conglomerates in the nation. Insull’s strategy was to sell securities in his companies to many small investors who were not knowledgeable about the industry. These individuals believed their investments were sound, even though profits were inflated and debt hidden by deceptive accounting (Cudahy & Henderson, 2005). Insull eventually took on too much debt without enough revenue to pay investors and his structure of holding companies collapsed. Several legislative acts were enacted as a direct result of Insull’s collapse, including the 1930s Securities Acts. Like the abuses perpetrated by Jay Cooke, this was another example of corporate crime involving manipulation of investors and billions of dollars in losses.

Unlike the previous two cases, the third case of corporate crime took place in an entire industry instead of one organization or group of organizations. The Savings and Loan (S&L) Industry began to decline by the late 1970s due to an increased focus on investment and commercial banking (Immergluck, 2009). In order to help S&Ls compete, Congress deregulated the industry and allowed them to issue risky loan products with adjustable interest rates (White, 1991). S&Ls participated in risky investments, eventually leading to widespread mortgage defaults and the subsequent collapse of several hundred local S&L institutions. The government was forced to pay back individual investors insured by the Federal Deposit Insurance Corporation (FDIC), amounting to hundreds of billions of dollars in losses (Curry & Shibut,
2000). This was the largest corporate crime case in American history at the time, causing an
extraordinary amount of damage to the economy and the legitimacy of financial institutions.

The fourth case is the Enron scandal, a modern example of the harm that can result from
the irresponsibility of corporate organizations. Enron was originally a natural gas pipeline
company that adapted into an energy trading company. Enron used mark-to-market accounting
to speculatively inflate asset values and remove debt from accounting records through the use of
shell corporations (McLean & Elkind, 2003). The goal was to create the illusion of consistent
profits in order to continue expanding the corporation. Eventually, new projects were not being
developed at a rate fast enough to pay dividends to shareholders, who were constantly being
assured of Enron’s financial stability. Enron’s stock value dropped to nearly zero as the largest
bankruptcy in American history up to that point ensued (Windsor, 2009). Enron’s case was the
first, and arguably most egregious, in a long list of corporate scandals from the 2000s.

Each of these crimes is large in scope and scale, providing a view of different types of
corporate crime from the 1800s to the early 2000s. The sheer magnitude of these crimes
illustrates that fraud has indeed consumed entire organizations and industries in the past. The
discussion will now turn from an overview of the four cases to the main reasons why corporate
crime research has important implications for both scholars and practitioners.

The Importance of Studying Corporate Scandals

Corporate crime research is essential to uncovering contributing factors to abuses
perpetrated by many modern corporations on society. Corporations have become a fixture in the
everyday lives of people around the world, supplying goods and services and influencing
governmental policy to their advantage. Failing to recognize the influence corporations have in a
modern, post-industrial, globalized world allows them to have complete control over an industry
without checks on the powers of corporate decision-making. This section outlines four important reasons for this thesis on corporate crime and serves as a call for increasing the attention given to the structured opportunities for fraud within corporations and the financial system in general. These include: 1) continued corporate scandal and harm, 2) lack of scholarly literature, 3) absence of appropriate methodologies, and 4) the need for effective policies.

Continued Corporate Scandal and Harm

Corporate crime is an ongoing problem that has not been adequately addressed. The volume and magnitude of fraud in the mortgage industry illustrate this point, as the problem stretched to encompass an entire industry. This eventually led to the collapse of investment banks and an influx of taxpayer money into the banking system to prevent further failures. Crises like this are not unique and have consistently occurred in the United States and other nations. Corporations like Enron and WorldCom were previously thought to be financially sound but collapsed under the weight of fraudulent financial structures (Skeel, 2005; Giroux, 2008). Tyco, Adelphia, Global Crossings, HealthSouth, and Fannie Mae were also involved in scandals concerning accounting fraud and CEO looting of corporate funds through stock price manipulation (Giroux, 2008). These scandals have undermined public trust in business and government, bringing about a lack of confidence in these heavily relied upon systems (Punch, 1996; Fulmer, 2009). This widespread corporate crime is the culmination of a near-endemic failure of regulatory structures. The current thesis looks extensively at these crimes, highlighting the persistence of corporate misconduct and lack of clear direction for handling the problem.

The Lack of Scholarly Literature

White-collar crime is understudied within the criminological literature and has not been given weight equal to the study of street crimes. In particular, corporate organizations and the
actions of corporate officers have been severely understudied by scholars (Simpson, 2002). Researchers have called for increased literature on white collar and corporate crime for over thirty years, but the majority of scholarly attention given to this complex subject lacks depth of content and continues to be underrepresented (Lynch, McGurin, & Fenwick, 2004). Criminology and the criminal justice system tend to focus on the behavior of an individual person, separating the criminal incident from the surrounding circumstances to be examined as a single case of crime (Geis, 2007). Organizational deviance does not fit into this mold and does not receive the same priority in research, despite the fact that criminology has grown into a separate field from sociology, or the study of organizations and human behavior (Geis, 2007).

The study of corporate actions and fraud in general tends to be complex, with numerous indirect relationships and causal pathways, making analysis difficult. Corporate crime research involves studying non-traditional methods of committing crime, requiring researchers to branch out into different fields, including economics, sociology, organizational psychology, and finance. To study corporate crime requires criminal justice researchers to incorporate the interactions of corporate offenders with the police, courts, and the correctional system, while expanding criminological theories to account for the regulatory system of government and the organizations it is charged with overseeing. The current thesis focuses extensively on the actions and inactions of regulatory agencies, as well as providing guidance for further research into corporate financial fraud.

The Absence of Appropriate Methodologies

Corporate crime research is often comprised of case studies focusing on a single case of corporate harm or scandal (Vaughan, 1983; Calavita & Pontell, 1990; Aulette & Michalowski, 2006). This creates generalizability issues, in that a single case study is difficult to apply to other
situations. Likewise, comprehensive analyses of corporate crime have been scarce, and those that have been conducted lack in-depth, qualitative data upon which to formulate effective policies to mitigate the problem (Sutherland, 1949; Clinard & Yeager, 1980). Alternative methodologies are necessary to provide structure for the analysis of both individual and organizational influences on the decision-making processes involved in major corporate crimes (Geis, 2007). Scholars should study financial scandals and develop a methodology to more effectively analyze corporate fraud. The current study adds to existing literature by taking a historical look at corporate crimes and not restricting the analysis to cases defined as illegal at the time of the offense. By applying a theoretical framework to multiple cases of corporate crime throughout American history, the discovery of patterns consistently affecting both the behaviors of and influences on corporate offenders will be possible.

The Need for Effective Policies

Despite continuous problems with a structural system that promotes fraud and other crimes, there has been no serious attempt to address the root causes of corporate abuse on a policy level. While calls for reform tend to result from major corporate crimes, the policies enacted are either watered down over time through lobbying efforts for deregulation by corporate interests, or by the initial failure to solve the fundamental underlying problems. Many opportunities for corporate crimes could be limited by simple policies designed to provide checks in corporate structures and eliminate possible conflicts of interest for government and corporate entities (Benson & Simpson, 2009). Further study into major corporate crimes will uncover areas that should be addressed by updated policies, as well as other prevention mechanisms that can be utilized by both corporations and the government to reduce harm caused by corporate crime. This thesis places an emphasis on discovering the failure of policies to prevent financial
scandals, and provides guidance for policymakers to address the roots of the problems instead of merely mitigating the symptoms of them.

**Goals of Thesis Research**

Four financial scandals will be applied to an adaptation of a framework originally developed by Sherman (1978) to examine police corruption scandals. This analysis led to the discovery of: 1) a continuous cycle of scandals, and 2) efforts aimed at the prevention of future crimes. A comprehensive analysis of corporate scandals involving complicated financial transactions and corporate structuring mechanisms will promote a greater understanding of the measures necessary to control the abuses undermining the legitimacy of the financial, political, economic, and justice systems (Punch, 1996; Cullen, Maakestad, & Cavender, 1987). The specific research questions of the current thesis will now be examined in greater detail.

**Research Questions**

The important issues to consider when studying corporate crime include the source of the crime, the size and scope of the social harm, and possible policy implications to prevent future crime, among others. The current research will highlight some of these issues pertaining to corporate scandals. The following three questions are the focus of the present thesis:

1) *What are the societal responses to major financial and corporate crimes?*

2) *Have these societal responses to major financial and corporate crime been effective in terms of a) mitigating damage and harm and b) preventing future crises?*

3) *What are the policy implications to be drawn from an examination of major financial and corporate crimes, specifically in regards to preventing future crises?*

First, this thesis will determine the societal responses to major financial and corporate crimes. These responses are indicated by a public outcry resulting from corporate scandal and
harm. The effects of these major corporate and financial crimes are felt on wide scale, with the harm done often overwhelming government efforts to offer assistance to victims. The responses to these corporate crimes are different depending on the nature of the scandal, with different approaches being taken to calm a rightfully angry public. An analysis of scholarly literature, archival newspaper accounts, and government actions in the wake of corporate scandals reveals the various responses to corporate crimes and the sentiment toward the entities involved in those crimes.

Second, this thesis will explore the effectiveness of responses at mitigating the damage caused by the crimes and implementing protections from future crises. Analyzing several cases of corporate crime involving complex organizational structures and financing methods led to the discovery of different macro-level responses. Common patterns found in the responses by government and private enterprise will help determine how well responses addressed key underlying issues. As all the cases in this thesis involved some type of policy reform as a response, understanding their effectiveness will assist policymakers in shaping what course of action to take when subsequent scandals occur.

After determining their effectiveness at mitigating harm and preventing future crises, the policy implications and alternatives will be considered. The immediate responses of the government and other entities have not always been the most effective at addressing the underlying causes of corporate scandals. Analyzing patterns throughout history will identify policy responses that have been effective, responses that made problems worse, and policies that were a waste of time and resources. While this analysis will not be able to identify a policy that will prevent all corporate crime in all cases, the framework should provide a solid basis for
future research into corporate crimes and draw attention to the need for alternatives to current approaches.

Research Plan

The remainder of this thesis consists of the history of corporate crime, attempts to address the harms caused by these crimes, and an in-depth guide for policy to address problems creating opportunities for misconduct in business. Chapter II will explore the development of white-collar crime as an area of study, as well as previous research on corporate crime and scandals. Chapter III will outline the methodology used to analyze these cases. Chapter IV will detail the histories of the four corporate crime cases. Chapter V describes the results of the analysis and explores common patterns found by using the organizational framework. Chapter VI discusses alternatives to current policy approaches and provides a guide for further research.
CHAPTER II

LITERATURE REVIEW

This chapter provides an overview of prior literature pertaining directly to white-collar crime, corporate crime, and corporate scandals. Discussed here will be the various aspects of problems related to these unique crimes. The chapter will be organized to examine the following issues: 1) white-collar crime conceptualization, 2) corporate crime research, and 3) prior research on corporate scandals.

White-Collar Crime Conceptualization

Over the years, scholars have applied different templates to “white-collar crime”: the social characteristics of the offender, the behaviors that create the crimes, and organizational and occupational forces, among others. Academics and practitioners alike have failed to agree on how to conceptualize white-collar crime (Geis, 2007). Many different forms of the term are used, including white-collar, business, professional, organized, corporate, economic, elite, occupational, corporate, governmental, political, and respectable crime (Friedrichs, 1996). This section will examine the evolution of the concept of white-collar crime, including 1) offender-based definitions, 2) offense-based definitions, and 3) opportunities to commit the crimes.

Offender-Based Definitions

Sutherland (1940) introduced the concept of white-collar crime in order to illuminate the crimes committed by the upper class. Sutherland was the first to offer a theoretical explanation for these elite crimes, which are fundamentally different in nature from traditional street crimes (Cullen & Benson, 1993). He defined white-collar crime as “a crime committed by a person of respectability and high social status in the course of his occupation” (Sutherland, 1983, p. 7).
other crimes that would be counted by conventional means, such as murder and drug or alcohol use.

Sutherland’s (1940) definition of white-collar crime included only a certain type of offender, namely those who were respected and of higher socioeconomic status. This excluded acts committed by those in occupations typically held by those of the lower or middle classes. A plumber, for example, who deliberately charged a customer for an expensive service when the problem could be fixed by a simpler and cheaper means has committed fraud by deception and abuse of trust, but would not be considered a white-collar criminal according to Sutherland (Benson & Simpson, 2009). A contention arose with this use of the socioeconomic status of the offender as a characteristic of defining white-collar crime. Sutherland’s purpose was to focus on crimes committed by upper-class individuals due to the dominance of lower social class criminals in criminological research at the time. The use of social class in the definition created problems for researchers by preventing the use of the variable to search for differences in white-collar crime among classes. Another issue with this definition involved the inclusion of non-criminalized actions as white-collar crimes, such as those violating administrative or civil laws. This problem related to the types of violations included in the definition is inherent in the study of white-collar crime (Benson & Simpson, 2009).

**Offense-Based Definitions**

Years later, another school of thought about white-collar crime took a different focus than the offender-based perspective of Sutherland. Edlehertz (1970) was one of the first scholars to focus on white-collar crime from the perspective of the offense and not the characteristics of the offender. His definition of white-collar crime was “an illegal act or series of illegal acts committed by non-physical means and by concealment or guile to obtain money or property, to
avoid the payment or loss of money or property, or to obtain business or personal advantage” (Edlehertz, 1970, p.3). He took the socioeconomic characteristics of the offender out of the definition, focusing instead on behaviors directly related to the offense. This same perspective was taken a decade later by the Yale Law School Project, a group of scholars who focused solely on white-collar criminal offenses in federal jurisdictions (Weisburd, Wheeler, Waring, & Bode, 1991). The Yale group disagreed with Sutherland, stating that white-collar crime was not concentrated among the higher socioeconomic classes but instead was spread out to include other social classes as well (Weisburd et al., 1991). Shapiro (1990) offered another way of conceptualizing white-collar crime. She argued that the focus should be on the harm caused by the offense, not on the individual offenders themselves. She thought the organizational forces influencing crime among businesses were largely missed by focusing solely on the offender. Her idea of white-collar crime was to contain all violations of a position of trust, not just specific law violations (Shapiro, 1990).

Offense-based definitions improve the ability of researchers to operationalize white-collar crime by allowing for the choice among known criminal acts. However, these definitions miss the more intriguing and damaging offenses that do not come to the attention of the criminal justice system. These are the types of offenses committed by elite figures Sutherland (1940) originally brought to the attention of criminologists. Many serious white-collar crimes, such as dangerous consumer products, hazardous waste, and unsafe working conditions, are not usually reflected in official records (Benson & Simpson, 2009). These approaches also did not account for the elite, upper-class figures whose offenses do not become widely known to the public or law enforcement.
Sutherland (1940) underscored these deficiencies while noting that elite offenders are often able to escape official sanctions. Many of the crimes by businesses, and the individual decision-makers involved in them, are not specifically defined as illegal in the criminal statutes. Societal elites often use their wealth, power, and/or social status to shape the content of criminal law and the severity of criminal sanctions. As a result, crimes of the elite can go unnoticed and unpunished. If these crimes are punished, criminal defendants are often comprised of non-elites, such as mid-level managers or other non-executive corporate actors (Wheeler, Weisburd, Waring, & Bode, 1988). Powerful individuals who are able to avoid criminal sanctions for their actions are excluded from the study of white-collar crimes if only offense-based conceptualizations are used (Benson & Simpson, 2009). While offense-based approaches could be used to focus only on high-status individuals, this has not been accomplished thus far in empirical research on such crimes (Benson & Simpson, 2009).

**Opportunities to Commit Crime**

Attempts have been made to reconcile offender-based and offense-based definitions. Some researchers have focused on the unique techniques used to commit white-collar crimes and the opportunities available to carry out those techniques (Benson & Simpson, 2009). Sutherland (1940) recognized every occupation inherently contains unique relationship dynamics that allow for unique crimes to occur. These crimes revolve around the misuse of a position of power, causing a breach of trust held by a person in that position (Sutherland, 1940). That is, a person must be in a position to commit a crime by deception, misrepresentation, or manipulation in order for a white-collar crime to occur. Those in higher social classes are more likely to occupy these positions and should be more likely to commit white-collar offenses due increased opportunity. Lower socioeconomic status individuals who do not occupy higher positions of
trust do not have the same opportunities to commit white-collar offenses, and therefore are more likely to commit street-level offenses (Benson & Simpson, 2009).

The issues with these varying definitions and typologies of white-collar crime are not easily resolved, as the lack of conceptual consensus can lead to frustration for researchers. The sheer complexity of the problem has led many to give up on attempts to reconcile the differences found in the study of white-collar crime (Geis, 2007). As the methods for committing white-collar crime have become increasingly complex, it has become essential to focus on the organizational forces at work in the concept of corporate crime. The macro-social analysis conducted in this thesis aims to address some of these deficiencies by suggesting a systematic method for analyzing crimes by organizations.

Corporate Crime Research

Missing from many earlier scholarly treatments of white collar-crime is the question of who benefits from the criminal act. Illegal or immoral acts committed to sustain a company are different from crimes with a goal of personal gain. Corporate crime, as opposed to the more individualistic focus of the general concept of white-collar crime, focuses primarily on offenses committed as a result of organizational deviance. Corporate crime is defined as “socially injurious and blameworthy acts, legal or illegal, that cause financial, physical, or environmental harm, committed by corporations and businesses against their workers, the general public, the environment, other corporations or businesses, the government, or other countries” (Frank & Lynch, 1992, p.17). The government can punish these acts either through administrative, civil, or criminal statutes (Clinard & Yeager, 1980). Corporate crime consists of patterns of behavior within an organization or industry that violate the law on a wide scale, not crime on an individual basis (Reiss & Tonry, 1993). The discussion will proceed with a general history of corporations,
followed by major factors related to the development and disposition of crime by corporate organizations.

*The Context of Corporate Crime and Organizational Deviance*

The study of corporate crime would be incomplete without placing the operations of modern corporations into context. Corporations have unique structures, functioning, and protections. This section will examine corporations from various aspects and the contribution of each factor toward business crime. These include: 1) corporate structure, 2) limited liability, 3) expansion of corporations, 4) expansion of due process and criminal liability to corporations, 5) securitization, and 6) prevalence of corporate crime.

*Corporate Structure*

In order to understand corporate crime, it is important to first look at the evolution of the organizational structure of American corporations. Corporations became the major entity for enterprise in American business due to the special powers afforded to them not given to other structural forms of companies (Skeel, 2005; Harley, 2008). Entrepreneurs desired to obtain corporate charters because of the advantages of limited liability not found in sole entrepreneurships or partnerships. Corporations are separate entities by law that are considered permanent regardless of the actions of its individual members (Skeel, 2005). The corporate structure also allowed for the pooling of resources in order to raise the necessary money for continued growth and expansion of business (Bernard, 1984). The corporation could hold property, issue lawsuits, and take legal action in the name of the corporation and not individual shareholders (Skeel, 2005). This structure of pooled resources and lack of individual responsibility allowed individual corporate offenders to conceal their crimes in the complicated
corporate structure, claiming a lack of knowledge or personal liability from any harm done by
the actions of the corporation.

*Limited Liability*

Corporations enjoy the advantage of limited liability, where the risks involved in
financial transactions are diffused across all the owners of the company (Skeel, 2005).
Corporations are made up of individual shareholders who each own a certain percentage of stock
in the company. Owners of a corporation are financially liable for no more than their ownership
stake in the company, with debts being payable to creditors only through corporate assets (White,
1991; Harley, 2008). Limited liability remains attractive to managers and shareholders because
it relieves individual shareholders from responsibility for the corporation’s debt. Shareholders
may lose their entire investment if the corporation fails but will not be personally liable for
paying back debt and losses to creditors (Skeel, 2005). These protections afforded to
corporations allowed them to operate in relative safety from accountability for the potential harm
caused by their collective actions. It was limited liability and other protections that contributed
to the rapid expansion of corporations in the United States during the nineteenth century.

*Expansion of Corporations*

While it is relatively easy to obtain a corporate charter today, this has not always been the
case. Prior to the mid-1800s, corporations operated similarly to government agencies as opposed
to the corporations of today, with specific rights to control the business activities of a certain
aspect of an industry (Bernard, 1984). Incorporation was done at the state level with strict
scrutiny of the business to ensure compliance with restrictions on their structure and purpose
(Cullen et al., 1987). As the demands of production brought on by the Industrial Revolution
increased and the focus of the nation was on economic prosperity through advances of
technology to support the expansion of communication and transportation, the strict regulation of corporate charters began to erode. Business owners demanded the protections and advantages of incorporation, and states began to incorporate more businesses than ever before (Cullen et al., 1987; Skeel, 2005). By the end of the 1800s there were over 500,000 corporate charters in the United States compared to a mere 335 at the beginning of the century (Skeel, 2005).

During the early decades of the Industrial Revolution, corporate expansion resulted in significant opportunities for organizational deviance and crime. First, corporate wealth and influence were used to escape responsibility for various crimes, including dangerous workplace conditions, fraud, price gouging, and stock manipulation. Political influences became intertwined with the interests of the state, enhancing opportunities for organizational deviance (Cullen et al., 1987). Second, corporations sought to create monopolies over certain sectors of industry to control competition, keep prices affordable, and plan for long-term expansion (Harley, 2008). This monopolistic focus gave corporations incentive to hide their crimes through the use of complicated corporate structures (Cullen et al., 1987). The issues surrounding the political influence and monopolistic practices of corporations made it difficult to effectively sanction corporate criminal behavior. The next section will highlight the laws and protections regarding the governance of corporate behavior.

*Expansion of Due Process and Criminal Liability to Corporations*

The late 1800s was a time where a pro-business attitude permeated the government’s treatment of corporations. Not only had laws been set up giving businesses advantages over other human rights interests, government subsidies were provided to help fund these organizations. The Supreme Court issued decisions shaping a laissez faire attitude toward large industry (Cullen et al., 1987). In the case of *Santa Clara County v. Southern Pacific Railroad*
(1886), the Court ruled that corporations were to be considered persons under the law and extended them due process rights according to the Fourteenth Amendment ratified in 1868. The Court created the concept of liberty of contract, which gave corporations protection from governmental regulations and their own employees, making it harder to impose controls on corporations (Cullen et al., 1987). These rights have allowed corporations to remain powerful and influential forces on the economy and policy, making it difficult to effectively hold corporations accountable for misconduct.

While due process rights were extended to corporations at the end of the 1800s, criminal liability for corporations would develop a few decades later. While civil liability has existed since the inception of corporations, criminal liability has been subject to greater dispute. Various judicial decisions and reformatory laws slowly expanded the concepts of criminal liability. Many American businesses that created railroads and canals were held criminally liable for failure to maintain the structures because a deteriorating infrastructure created a public nuisance (Bernard, 1984). The first decision to attribute criminal intention to corporations was New York Central and Hudson River Railroad Co. v. United States (1908), where railroad companies were held liable for inadequate upkeep due to the knowledge and intent of the individual agents acting on behalf of the business. Corporate criminal liability was later extended to homicide against Ford Motor Company for deaths that occurred after the company knowingly neglected to correct a safety malfunction in the gas tank of the Pinto, causing tanks to explode on impact (Cullen et al., 1987). Corporations would be held criminally liable due the attribution of levels of intent other than purposive, including negligence and recklessness, which would determine the business’ level of responsibility for socially harmful actions (Reiman, 2004). Through these and other
Court rulings, corporations were thrust into the realm of the criminal courts, extending to these institutions the rights and responsibilities originally designed for individual persons.

A new method of raising money was introduced in order to fund the Industrial projects of the 1800s. Securitization is the primary method of funding the continued growth of corporations. It opened the door not only for prosperous new possibilities, but created unprecedented opportunities for financial crimes. This discussion of corporate operations must also include an examination of the transactions made by corporations and methods of funding corporate activities through securities.

Securitization

Aside from the expansion of due process rights and criminal liability to corporate organizations, the beginning of incorporation and the distribution of liability in companies to multiple shareholders was the early start of what became known as securitization. As the United States moved from the Industrial Age into financial prosperity, corporations remained at the helm of American progress. Corporations became a natural part of everyday life by supplying consumers with a wide variety of goods and services. Industries became focused on efficiently producing and distributing goods as quickly and cheaply as possible, while creating advertising and marketing divisions to find new customers (Cullen et al., 1987). Competition drove the markets to control costs by relying on the economic principles of supply and demand. The stock market became a strong force, creating new opportunities for ordinary people to invest their money in corporations with the possibility of attaining great wealth. This was done by the purchasing of stock, or a security, offered by corporations to provide funding for their continued growth and prosperity.
Securities are an ownership or debt, signified by a piece of paper or account number, stating an individual’s financial stake in a company or other economic entity (Benson & Simpson, 2009). Stocks, bonds, and shares are all examples of securities. Securities can be backed by many types of investments in particular industries, including but not limited to, energy, manufacturing, real estate, and transportation. The buying and selling of securities is based on the trust of the individual shareholders in what is told to them by company leaders. Corporations are technically owned by anyone who holds a security in the corporation, while the everyday operations of the business are placed under the control of executive officers. Corporations receive the majority of their funding through the investments of shareholders who purchase a security and own a small piece of the company (Skeel, 2005).

This exchange of securities created entirely new opportunities for fraud that did not rely on the actual theft or misrepresentation of physical assets. Securities offenses make up a large portion of corporate crime, which involves taking advantage of a position of trust and manipulating economic markets for financial gain. Shapiro (1984) used data from the Yale studies on white-collar crime to identify five major types of securities offenses: misrepresentations, stock manipulation, misappropriation, insider trading, and investment schemes. Misrepresentation involves deceiving an investor into believing something about an investment opportunity that is not entirely true. Stock manipulation is artificially increasing the price of stock to create the false impression that the investment is worth more than it actually is. Misappropriation is when a stockbroker, entrusted to make purchases of stock on behalf of an investor, uses the victim’s money for the brokers’ personal benefit. Insider trading involves purchasing securities based on information about the company that is not available to the general public. Finally, investment schemes are deliberate attempts to trick investors into giving up their
money for a fraudulent opportunity in order to steal it, such as in ponzi or pyramid schemes (Shapiro, 1984). All of these offenses depend on some sort of manipulation or deception toward victims who believe the word of a seemingly legitimate figure and end up being defrauded because of their trust (Benson & Simpson, 2009). Securities offenses and other financially related crimes will be the primary focus of this thesis.

The securities market opened up new opportunities for fraud and misconduct by corporations in order to advance their organizational and private interests. Corporations continue to enjoy many governmental and legislative protections, often remaining free from facing the consequences of their actions. These facets of the corporate form have been successful at promoting commerce in an increasingly globalized society by supporting the goals of economic prosperity and efficient access to a vast array of goods and services. However, these same qualities also provide numerous opportunities for wide-scale crime by creating the context for corporate crime and deviance.

Prevalence of Corporate Crime

Crimes committed by corporations cause more death, physical injury, and property loss than all the UCR Index crimes (Harley, 2008). In a study of seventy major corporations in the 1940s, Sutherland (1949) discovered a total of 583 court decisions against corporations, sixteen percent (16%) of which were criminal offenses. Sixty percent of these corporations had four or more convictions, which classified them as habitual offenders (Sutherland, 1949). A similar study by Clinard and Yeager (1980) revealed 1554 criminal offenses by 582 corporations, with only 371 receiving a relatively small penalty. Only sixteen corporate executives received a total of 594 days of incarceration, collectively equaling less than two years of punishment (Clinard & Yeager, 1980). The total number of corporate and securities fraud cases have been increasing
each year, moving from 279 federal cases in 2003 to 529 cases in 2008 (Federal Bureau of
Investigation, 2008). The total costs, after accounting for harms to consumers, employees,
citizens, and society as a whole, is impossible to fully measure but is undoubtedly greater than is
currently calculated due to the dark figure of crime (Mokhiber, 1988). These statistical
examinations of corporate harm illustrate the prevalence of crime committed by corporations.
The correlates and instigators of these crimes will be examined next, with an emphasis placed the
sources, regulations, and methods of sanctioning corporate crime.

Correlates and Instigators of Corporate Misconduct

This section will account for the various factors contributing to corporate misconduct.
First, the potential sources of corporate crime will be explored. Second, a history of regulations
and the roles of various government agencies will provide a context to examine the enforcement
and control of business crime. Third, methods of sanctioning known corporate crime offenses
will illustrate the relative reluctance and ineffectiveness of control mechanisms.

Sources

While the causes of corporate crime remain opaque, many patterns of behavior are tied to
organizational deviance. These sources of corporate crime are characterized by the interactions
between corporate actors that shape an offense. Punch (1996) outlined six types of deviant
behavior that make up business crimes. The first three involve individual white-collar crimes,
where employees act in ways that defraud the company they work for, either to gain special
privileges, avoid work, or gain illegal monetary advantages. The fourth type of deviance is
where the employees act on behalf of the organization for the betterment of the organization,
either by ignoring safety regulations or bending rules. The fifth deviant behavior is
organizational deviance that encompasses an entire organizational culture. It involves acts of
deception, stealth, and other deliberate practices to achieve both formal and informal goals set by the organization. The organization managers often support these acts either directly or indirectly by their direct commission of the behaviors or the omission of employee sanctions. The sixth involves deviance on the part of the managers who use the power and trust of their positions for personal gain, potentially damaging the corporation and the shareholders in the process (Punch, 1996). This thesis will focus on the latter three types of organizational misconduct, with the greatest emphasis given to organizational deviance as one of the defining characteristics of corporate crime.

Deviance can permeate throughout an entire organization through the culture, which dictates both acceptable and unacceptable behavior. Managers at the top of the organizational hierarchy set goals that are passed down throughout the organization. The methods used to achieve those goals, however, are not always clear to lower level employees and middle managers. Employees often find themselves striving to meet unrealistic goals, increasing the incentive for them to use illegitimate means to achieve them (Vaughan, 1982). If illegitimate means are condoned within an organization as a way of achieving various goals, the organization can be classified as deviant. This organizational deviance can be described as a criminogenic firm culture, where illegal behavior becomes commonplace within the organization due to pulls from the environment leading toward criminal behavior (Simpson, Paternoster & Pirqero, 1998). In a business setting, these pulls are driven by market and legal constraints on the ability to make profits through legitimate means.

The culture of the organization can provide the opportunity, motivation, and rationalization for breaking the law in the course of business (Coleman, 1989). Employees and managers make these decisions everyday to the point where the interactions become routine and
no one questions whether they are legal or ethical (Simpson, Piquero, & Paternoster, 2002). Once this cycle of decision-making is set within an organization, it becomes difficult to change even if environmental strains happen to change. The risks and ethics of potentially harmful decisions become normalized, or the acceptable way of doing business (Vaughan, 2005). Crime may not necessarily be purposely intentional but the legality of decisions is not questioned, making them neglectful or reckless (Reiman, 2004). Individualistic thinking is downplayed, as pressures to conform to the consensus of the organization are placed on those who propose alternative courses of action (Simpson et al., 2002). This culture of organizational deviance is a powerful force on individual decision-making and provides an explanation for why criminal activity can be persistent throughout entire organizations.

Corporate leaders have goals for their organization and pass those goals down to their subordinates. Lawbreakers will see themselves as having a higher loyalty to their company than to the specific requirements of the law, justifying their behavior as having acted in the best interest of the organization for which they are employed (Benson & Simpson, 2009). Corporate leaders claim to be unable to track all the actions of their employees, who can go about achieving goals through illegal means. Leaders can then deny responsibility for the individual actions of their employees. This can work in reverse as well, as employees can avoid responsibility for their harmful actions by claiming to be following orders handed down from organizational leaders (Benson & Simpson, 2009).

The complex organizational structure of corporations makes it easier for their leaders to deny responsibility when social harm is caused (Clinard & Yeager, 1980). The complicated structure of corporations influences diffusion of responsibility, and can make it difficult to identify individual perpetrators. Individual corporate lawbreakers can avoid responsibility
within complex organizational structures by claiming ignorance and/or justifying their behavior. Those involved in risky behaviors may ignore the potential harm of their actions, and instead treat the harm as an unintended and unfortunate consequence of business (Benson & Simpson, 2009). In this way, individual corporate actors may be able to neutralize responsibility for their crimes (Reiman, 2004; Weisburd et al., 1991). Indeed, it is difficult to determine if an organization is made up of a few ‘bad apples’ or if the entire organization is structured to promote deviant behavior. This creates a problem for determining effective regulations and sanctions aimed at preventing and punishing corporate criminal behavior.

*The Control Context*

Attempts to control corporate misconduct have a long history mired in inadequacy and ineffectiveness. While the criminal justice system is responsible for addressing criminal activity, it is largely ineffective at handling the complexities of the corporate world. Police are not typically trained in effective methods for handling corporate crime, as traditional police investigation methods are designed to address individual and not organizational crime (Simpson, 2002). Most police work occurs at the local level, while corporate crimes often transcend the boundaries of city, state, and even country. Transactions are spread throughout international networks of individuals, governments, and business organizations. These complications leave corporate crime in the hands of federal agencies, with the use of regulatory laws to oversee corporate behavior. The strength of these regulations has gone in cycles with the performance of the financial markets (Simpson, 2002). Failing markets are perceived with increased levels of risk and accompany calls for reform, while strong markets rarely see dissent as long as profits continue to be made (Bellini, 2009). These trends demonstrate the tendency for public attitudes
to shift between those advocating pro-business concerns and corporate regulation, a pattern that will be highlighted by the four-case study of this thesis.

Business regulation has changed in three distinct waves throughout American history. The first wave was the Progressive Era, brought on by the excesses of corporate greed and political corruption that dominated the country during the Industrial Revolution (Simpson, 2002). This was the time of the ‘Robber Barons,’ where corporate interests sought to monopolize various industries. Calls for reform began to break through the laissez-faire, pro-business attitude consuming Congress and the courts at the time, as measures were slowly taken to limit the power of large corporations (Simpson, 2002). Numerous regulations were passed to give the government more control over large institutions, including the creation of the Interstate Commerce Commission (ICC) in 1887 and the Federal Reserve Board in 1913 (Simpson, 2002). The Sherman Antitrust Act was passed in 1890 to limit corporate trusts that threatened to hold a monopoly over an entire industry (Geis, 2007). In addition to these legal efforts, newspaper reporters and investigative journalists known as ‘muckrakers’ sought to bring the neglect of workplace safety concerns by corporations to light (Geis, 2007). The laws were effective to some degree, being used to break up John Rockefeller’s Standard Oil trust that dominated the oil industry throughout the latter part of the nineteen-century (Geis, 2007). At the beginning of the 1920s, however, political attitudes moved away from progressivism and calls for regulatory reform as a pro-investment sentiment in favor of Wall Street took hold once again.

The second wave of regulation was ushered in with the onset of the Great Depression in 1929, as businesses and Wall Street executives were blamed for irresponsible behavior contributing to the crisis (Simpson, 2002). The corporate scandals involving the collapse of the Insull utility holding companies and others resulted in the passage of the 1930s Securities Acts to
regulate the sale and distribution of securities investments (Cudahy & Henderson, 2005). This was just one of the New Deal reforms passed in the 1930s, as the Federal Communications Commission (FCC), Securities and Exchange Commission (SEC), the Federal Deposit Insurance Corporation (FDIC), and the National Labor Relations Board (NLRB) were all created to help protect citizens from business misconduct (Simpson, 2002).

The third wave of regulation began in the 1960s and 70s. The prosperity of the economy following World War II led to increased focus on safety and environmental concerns. Out of this came the creation of the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA) (Simpson, 2002). Recent corporate scandals have also brought about calls for regulatory reform. The Enron and WorldCom collapses in the early 2000s led to the Sarbanes-Oxley Act of 2002, which tightened accounting regulations and increased penalties for securities offenses (Skeel, 2005). The recent sub-prime mortgage crisis has produced calls for reforms to financial regulations as well, with a final reform bill addressing the financial services industry being negotiated in Congress as of this writing.

While these various reforms and regulations were designed to limit the power of businesses, they often produced results contrary to their original intention by helping insulate business activities more than control them (Cullen et al., 1987; Simpson, 2002). Federal agencies became the means through which to regulate and investigate businesses but were not given the proper resources or authority to adequately meet these responsibilities (Cullen et al., 1987). Many of these agencies were plagued with a mentality characterized by lax enforcement, which allowed harmful business activities to carry on without significant government intervention (Simpson, 2002). These regulatory agencies became focused on legalistic and formal procedures, applying universal rules to corporate crime issues that require unique,
problem-oriented approaches. The focus on the actual harm done by a corporation had been
downplayed, resulting in drawn-out legal battles that often failed to achieve results (Simpson,
2002).

Regulations are designed to ensure compliance with rules and standards of behavior, not
for punishing those who do not adhere to them (Simpson, 2002). Some studies from the 1970s
show that federal agencies charged with enforcing these regulations mostly do not see
themselves as law enforcers (Braithwaite, 1985). Many regulators viewed their role as working
with organizations to gain compliance with laws for the purpose of achieving a broader goal,
such as safer factories, cleaner air, or increased levels of healthy competition (Braithwaite,
1985). Punishment was not often used as a method of achieving these goals.

Simpson (2002) argued that one problem possibly contributing to this lack of regulatory
effectiveness is the ‘Revolving Door,’ which hypothesized that regulatory agencies are often
headed by leaders from the business world working to maintain the status quo while in public
service before returning to their corporate positions. Examinations of this hypothesis yield
conflicting results, but a study by Frietag revealed thirty-two percent of commission leaders from
1887 to 1975 were chosen from corporations, while sixty-percent were recruited into
corporations after their appointment ended. The overlap of regulatory leaders and corporations
varied greatly over time and by agency, but the most frequent overlap was found in the SEC, the
agency responsible for overseeing securities exchanges. This apparent lack of effectiveness of
regulatory agencies for controlling corporate behavior renders any deterrent effect they might
have to be minimal or nonexistent. A ‘Benign Big Gun’ is held by regulators who place
cooperative enforcement strategies on the bottom of a pyramid of choices, with the rare use of
punitive sanctions at the top of the pyramid as a last resort (Simpson, 2002). A more detailed
discussion of methods for sanctioning criminal corporate behavior will now follow with an emphasis on the most prominent strategies for issuing sanctions and their ineffectiveness at deterring misconduct.

Sanctions

Federal regulatory agencies are the primary means through which corporate crime is addressed in the United States. The lack of effectiveness of regulatory agencies is apparent in their inability to either properly enforce current regulations or to have a deterrence effect. In a survey study of managers in an MBA program, Simpson (2002) found managers believed regulatory sanctions were the most likely result of business crime, with the effects of the intervention being felt more heavily by the organization than any responsible individual. They also signified that sanctions would be more effective if directed toward individual offenders, as the threat of criminal sanctions was more of a deterrent than civil or regulatory sanctions.

Regulatory sanctions seemed to be among the least of concerns to managers, who did not consider them a threat while also feeling protected from the possibility of criminal sanctions (Simpson, 2002). This signifies that the most often used sanction for corporate misconduct is also the least effective, while the least often used sanction is the most effective. However, when applied to an organization, criminal sanctions present a number of difficulties.

The major difficulty for developing the concept of corporate crime is determining criminal culpability. Unlike individual persons, corporations are made up of a complex array of relationships, power hierarchy, and deferred responsibility. When a crime leads back to a violation by a corporation, the major issue becomes determining who within the organization is liable for the crime (Geis, 2007). In the United States, corporations are treated as individual persons, in that they can be sued and have penalties imposed on them (Skeel, 2005). Usually,
law violations are sanctioned using civil rather than criminal means even when a criminal law is broken (Punch, 1996; Geis, 2007). The major contention against corporate criminal liability is the non-human aspect of the corporation, as criminal law is intended to address individual and not organizational behavior (Geis, 2007). Although it has been established that corporations have been extended due process rights and criminal liability through various Supreme Court cases, the actions of corporations are typically handled by regulatory agencies through the use of civil and administrative laws (Clinard & Yeager, 1980). Corporate executives will often try to make deals with victims by settling the case with a guilty plea in order to avoid negative publicity and the possibility of harsher criminal sanctions (Geis, 2007).

The understanding of the sources, control context, and sanctions of corporate crime is still in its primitive stages, as criminological research has not paid adequate attention to these corporate behaviors in comparison to street crimes. Studies of corporate crime tend to utilize secondary sources of information, placing individual cases of corporate crime in a criminological, organizational, or managerial framework. The literature relies on scandals, media, public inquiries, police investigations, and the testimonies of whistle-blowers (Punch, 1996). The following section will explore the literature specific to corporate scandals.

Prior Research on Corporate Scandals

In order to further understand corporate crime research, it is important to examine methods researchers have utilized to analyze these crimes. This section discusses some of the most important commonalities associated with prior research on corporate scandals. The focus will first be placed on three examples of the case-study approach to researching corporate scandals. The macro-social units of analysis common to the examination of all three of these
case studies will then be addressed, followed by a discussion of the interactions between corporations and government.

Case Study Methodology

The discussion of corporate scandals will begin with how researchers have past addressed corporate crime issues through the use of case study methodology. Three corporate scandal case studies will be used as examples, including: 1) the Imperial Foods fire, 2) the Exxon-Valdez, and 3) the Challenger explosion.

Imperial Foods Fire

The first case involved a fire at a chicken factory in North Carolina in 1991 that killed twenty-five workers and injured fifty-six more. Aulette and Michalowski (2006) looked at this corporate scandal in various contexts, beginning first with a historical overview of the case. They explained the political and economic history of North Carolina, creating an outline for understanding the failure of the government to properly ensure safe working conditions at the Imperial Foods plant. This failure on the part of government controls ultimately enabled the crime to occur. The researchers then looked at the institutional context of the crime, examining the failure of the company to heed numerous safety warnings. The failure of social controls are further explained, including the omission of vital safety violations by the federal and state OSHA agencies as well as the building examiners’ failure to bring building code violations to light. In the end, the coinciding forces of the lack of effective government oversight, a pro-business state culture, and a company environment that put profit over worker safety resulted in the deaths of plant employees (Aulette & Michalowski, 2006). By looking at the history, the societal and institutional contexts, and the failure of government controls, the researchers effectively explained the multi-faceted issues involved in a corporate scandal.
Exxon-Valdez

A second study that illustrated the case study approach is the *Exxon-Valdez* oil spill that occurred in 1989 off the coast of Alaska. Crucitti and Matthews (2006) examined this tragedy by looking at the event itself, then the various contexts involved in shaping the conditions leading to it. First, the immediate circumstances are addressed, including the delayed response on the part of cleanup crews to attend to the spill. Next, the researchers examined the different actors involved, including both their actions and inactions that contributed to the spill. Those responsible for handling a spill situation were inadequately prepared to deal with the problem, thus allowing eleven million gallons of oil to flow out of the *Valdez* into the Prince William Sound. The delay caused the oil to be spread out over 600 miles by a storm, washing onto nearby beaches. The Alyeska Pipeline Service Commission, the US Coast Guard, the Alaska Department of Environmental Control, the state of Alaska, and the US government all failed in their duties to ensure proper controls on the safety and environmental standards for Exxon, but also failed to adequately clean up the spill in the appropriate amount of time. Third, the researchers looked at the societal, political, and regulatory contexts that created the conditions for the crime to occur as well as the inadequate response to the spill. The case study concluded with the consequences of the crime, including environmental, human health, and legal implications (Cruciotti & Matthews, 2006).

Challenger Explosion

The third case involved the fatal explosion of the Challenger space shuttle that killed seven astronauts and one schoolteacher in 1986. In his examination of the explosion of the shuttle, Kramer (2006) explained the organizational interactions and pressures to launch the shuttle despite overwhelming evidence of safety risks. He looked at the societal context
surrounding the origin of the shuttle, including the politics involved in shaping the goals of the National Aeronautics and Space Administration (NASA) shuttle program. He then analyzed the organizational context involving the interactions with Morton Thiokol that resulted in the continued use of the faulty O-Ring that eventually caused the explosion. Pressures exerted on both Morton Thiokol and NASA contributed to the decision to launch despite obvious safety concerns. He concluded by demonstrating the lack of controls over Morton Thiokol and NASA, signifying a failure of regulation and oversight over the construction, engineering, and decision-making processes involved in launching the shuttle (Kramer, 2006).

These examples of corporate scandal case studies each have common contexts used to examine corporate crime. The use of the case study approach provides in-depth qualitative data beyond the more narrow quantitative analyses of existing data. The case study approach of these three cases incorporates macro-level units of analysis, in addition to highlighting the common patterns of governmental involvement with businesses that contributed to the crimes. These common macro-social factors will now be discussed.

**Macro-Social Units of Analysis**

All of the cases above involved incidents that are not merely unfortunate accidents, but crimes resulting from complex interactions between different social institutions and individuals. Each uses a similar framework based on these contexts to analyze the crimes and explain the impact of the interactions between the corporate and state entities involved. Kramer, Michalowski, and Kauzlarich (2002) explained this method of analyzing crimes involving the intersection of both state and corporate interests, which they described as state-corporate crime. First, a history of the cases is provided, focusing on the institutional environment surrounding the creation of the criminal activity. This narrative examines the culture of the organization and the
economic placement of the business among other institutions. Second, the organizational processes and structure are examined to determine how interactions both within and outside the organization shape the behaviors of the corporation. Third, individual interactions are examined to determine how specific violations of the law came together to form the corporate scandal (Kramer et al., 2002). These contexts provide a way of understanding the different aspects of the scandal. Instead of focusing on abstract concepts or individual offenders, these macro-social units of analysis focus on the organizations themselves to explain how a scandal occurs. Examining the societal, political, and regulatory/control contexts among others allow researchers to properly study scandals as multi-faceted and complicated criminal events.

Intersection of Corporate and State Interests

All of the contexts involved in analyzing corporate scandals illustrate one of their central characteristics, which are the interactions of corporations with the government. Without the involvement of government interests, a corporate scandal would be incapable of the same magnitude of harm. Since their inception in America in the 1800s, corporations and the state have been inseparably linked together and dependent on one another (Michalowski & Kramer, 2006). States rely on corporations to provide goods and services on a wide scale to meet various needs, while corporations need states for charters and contracts to expand their operations. Corporations would not have become powerful and influential forces without the ability to operate within the legal, economic, and political infrastructure of the government (Kramer et al., 2002). This mutually reciprocal relationship benefits both the state and corporations, but causes immeasurable levels of social and economic harm. All too often, it is consumers and taxpayers who are harmed by the interactions of these two powerful institutions and find themselves victimized without proper mechanisms for recourse.
Many forms of corporate crime are the result of organizational deviance at the intersection of business and government (Michalowski & Kramer, 2006). Due to the high levels of probable deviant behavior with these types of arrangements, corporate scandals are appropriately described as “interconnections between government and business, based on bribery, corruption, favoritism, and conflicts of interest” (Punch, 1996, p. 67). By understanding the link between the actions of government and corporate entities, possible solutions to the problem can be uncovered.

Conclusion

White-collar and corporate crimes are more harmful to society than all other forms of crime combined. This chapter has examined various methods used to study these crimes from the origin of white-collar crime as a field of study to the examination of larger-scale corporate crime offenses. Chapter III will illustrate the methods used in this thesis to examine four cases of corporate crime scandal.
CHAPTER III.
METHODS

This thesis explores financially-related corporate scandals that have resulted in harm to society and a societal response to that harm. The methodology used will focus on discovering common themes while utilizing a framework for understanding an apparent cycle of scandal and reform in securities and corporate law. A macro-social adaptation of Sherman’s (1978) study on scandal and reform in police organizations will be applied to all four financial scandals in search of common patterns to provide a basis for policy implications. First, the case study approach will be discussed in detail. Second, the use of the case study approach in this thesis will be outlined according to the components of a case study design as described by Yin (2009). Third, the limitations to the approach of this thesis will be explored.

Case Study Research Design

Case studies can be utilized for exploratory, descriptive, and explanatory research and are similar to a “case history” conducted on individuals in the fields of psychology and medicine (Hamel, 1992; Yin, 2009). They often involve the examination of one or more cases from multiple dimensions, and allow for the detailed, comprehensive analysis of the subject being studied (Yin, 2009). Case studies can use both qualitative and quantitative methods of analysis and should not be defined as falling exclusively under the realm of either method (Yin, 2009). The unique focus of case studies in research makes it an ideal method through which to examine financial scandals over time.

Corporate scandal literature, as discussed in Chapter II, consists primarily of case studies centered on contexts emphasizing common themes among the cases. The case histories that will be described in detail in Chapter IV provide the background from which to analyze the
commonalities among the cases. The common macro-social factors used to study the four cases in this thesis include 1) societal context, 2) political context, and 3) regulatory/control context. First, the societal context addresses the social environment surrounding the organization or industry. Second, the political context discusses the external political influences of legislative actions contributing to the criminal behavior. Third, the regulatory/control context focuses on the failure of formal and informal control systems, including regulatory agencies.

Similar contexts have been used to analyze other corporate scandals, including the Imperial Foods fire, the Exxon-Valdez oil spill, and the space shuttle Challenger explosion (Aulette & Michalowski, 2006; Cruciotti & Matthews, 2006; Kramer, 2006). The current thesis will use a similar approach to analyze four financial scandals. While many case studies have examined a single case, the multiple case study design involves separate analyses on multiple related cases (Yin, 2009). The goal of using the case study approach will be to examine financial scandals throughout history using a common framework in order to establish patterns among different types of large-scale offenses. A logic model will be utilized to identify repeating cause and effect patterns through a synthesis of the four cases (Yin, 2009). According to Yin (2009), an effective case study research design should contain five essential components, including: 1) research questions, 2) theoretical propositions, 3) units of analysis, 4) logic linking propositions, and 5) criteria for interpreting the results. The remainder of this chapter will be devoted to outlining these components and establishing how the analysis of this thesis will be structured.
**Research Questions**

The first component of a case-study design consists of the research questions as outlined in Chapter I. These questions are aimed at addressing societal responses to large-scale corporate and financial crimes. A brief summary of each of the questions and how this thesis will answer those questions is found below.

1) *What are the societal responses to major corporate and financial crimes?*

The first step in studying the effects of corporate scandals is to identify the responses of the public and the legislature to those scandals. The societal responses will be examined in order to understand the context within which the scandal took place. This question must be addressed in order to answer the following two research questions.

2) *Have these societal responses to major corporate and financial crime been effective in terms of a) mitigating damage and harm and b) preventing future crises.*

In order for a response to be effective, it must address one of two issues. The response should either mitigate the damage and harm caused by the scandal or take measures to prevent future scandals from occurring. The effectiveness of the response or lack of a response is the basis for the third research question that addresses the implications of the analysis.

3) *What are the policy implications to be drawn from an examination of major corporate and financial crimes, specifically in regards to preventing future crises?*

The ultimate goal of this thesis is to discern from various policy approaches to determine the effectiveness of reforms. The continuous occurrence of corporate scandals suggests that reform efforts are ineffective at addressing underlying problems leading to large-scale societal harm. This thesis will use the findings from the analysis to inform various policy alternatives.
**Thesis Propositions**

According to Yin (2009), an explanation of the research questions should be followed by a specific statement of purpose centered on a theoretical issue shaping the intent of the study. The purpose of this thesis is to determine the proper responses to major corporate and financial criminal scandals. This thesis proposes that by conducting a case study with replications of multiple cases of corporate scandal, a pattern of scandal and reform will be uncovered. This pattern of scandal and reform is the finding of Sherman’s (1978) study of police corruption scandals. This pattern of scandal and reform results from the lack of attention given to the underlying causes of the corporate scandals. These scandals are rooted in the opportunities for organizational deviance found in the modern corporate structure and the securities market. This thesis predicts that reforms have not been effective at fixing these problems, resulting in continued societal harm resulting from unmitigated corporate misconduct. The methodology is aimed at addressing these propositions and finding supporting patterns for them in the analysis.

**Units of Analysis**

Single cases of corporate and financial crimes will be the units of analysis used in this thesis. A “case” is defined as a corporate scandal that resulted in social harm. A scandal will consist of the entire grouping of crimes committed by an organization, individuals within the organization, or collection of organizations within a particular industry.

Individual scandals often result in significant reform initiatives. These reform initiatives are consistent with Yin’s (2009) concept of “embedded” units of analysis. Embedded units of analysis are those that occur within the context of the main unit of analysis. Societal reactions and reforms do not occur in isolation and must be examined within the context of the corporate scandals. Consistent with Yin’s (2009) conceptualization, the primary unit of analysis of this
thesis is the cases of corporate scandal, while subsequent societal reactions and reforms constitute the embedded units of analysis.

Information about these scandals and reforms should come from multiple sources and be integrated together (Yin, 2009). The data contained in this thesis was retrieved from scholarly literature, newspaper articles, government reports, and court decisions relating to the cases. A search for relevant material was conducted to find information pertaining to each of the cases with the applicability of each particular source being subjectively determined by the author. The triangulation of multiple sources of data is necessary in order to make inferences about the cases to answer the research questions. While the information being used will not be all-inclusive, the multiple documents and records used in the analysis will be sufficient to draw conclusions as to the general causal nature of the four scandals.

Four major cases of corporate and financial crimes were selected specifically for the widespread harm that resulted. The cases were chosen from various periods of American history in order to get a diverse sample of large corporate scandals. Different industries were chosen so as to examine consistencies in behaviors across time and place. The examination of the cases and their respective effects is limited only to corporate scandals taking place within the United States. The four cases include 1) Cooke & Co. and Northern Pacific Railroad, 2) Insull Utility Holding Companies, 3) the Savings and Loan Industry, and 4) Enron.

These four cases were selected largely for their involvement with financial crime, the scandal that produced a societal reaction, and a reform effort that resulted from the scandal. Cooke & Co. was selected due to the securities fraud involved in misrepresenting the soundness of the Northern Pacific Railroad project to investors, as well as the role of the scandal in ushering in one of the largest banking panics of the nineteenth century. The scandal also contributed to
legislative efforts to curb speculative securities sales. The collapse of the Insull utility holding companies is an example of corporate crime that occurred because of the misrepresentation of securities to middle and lower class investors, just as in the Cooke case. Insull’s investment firms consisted of complicated layers that confused investors, allowing Insull to fraudulently misstate the financial condition of his companies to promote continued investment for the expansion of business operations. It also contributed directly to several New Deal reforms that changed the way securities were issued and the utilities industry was governed.

The Savings and Loan crisis was the largest financial scandal in American history at the time, making it an essential case study for the examination of corporate crime. The fraud that permeated the entire industry provided lessons for policy that were not fully learned at the time, leaving unsolved many underlying problems that contributed to future crises. The Enron scandal is an egregious example of corporate fraud and greed. The entire culture of the corporation was criminogenic in nature, as employees were informally encouraged to break the law in order to inflate stock prices to gain extraordinary profits. The resulting Sarbanes-Oxley Act was one of the largest reforms of corporate governance since the Securities Acts of the Depression-era, making Enron an obvious case through which to analyze patterns of corporate crime and regulatory reform. These four cases are significant and provide an effective lens through which to view corporate scandal and reform. Each one will be linked together using a logical model to compare the cases and search for similar patterns.

**Logic Model and Cross-Case Synthesis**

In order to analyze the corporate scandals in this thesis, a method is necessary that allows for the examination of all the cases together in search of common patterns. This method should include aspects of organizational deviance, a scandal resulting from that deviance, and reforms
introduced as a direct result of the scandal. It is for these reasons that a model originally used for
studying corrupt police organizations was selected as the basis for this analysis. Sherman (1978)
developed a framework for the examination of police corruption in four major cities in the
United States. The goal of Sherman’s (1978) research was to gain a better understanding of the
development of police corruption in an organization and the effectiveness of efforts to change
those corrupt practices. Sherman (1978) highlighted the necessity of scandals in mobilizing
public outrage and subsequently influencing the creation of reforms. Scandals are used as social
control for an organization in order to bring about either internal or external changes with the
goal of reforming the police department to eliminate the corruption. Sherman (1978) went on to
discuss preventive and punitive controls over corruption, concluding with an examination of the
effects of the scandal and the control policies it produced. The study concluded with an
examination of the effectiveness of reforms, stating that organizations tended to revert back to
old patterns of behavior despite punitive sanctions unless there was an internally imposed reform
changing the behaviors of individual officers.

Sherman’s (1978) model utilized a microanalysis of the individual police organizations
and their internal structural reactions. By changing the model to fit a macro-social perspective,
the general framework used by Sherman (1978) can be applied to different forms of
organizational deviance. Instead of looking at reforms of individual police departments, this
thesis will analyze laws enacted by the federal government aimed at curbing similar forms of
corporate scandal. The model developed by Sherman (1978) will allow for the examination of
the four cases of financial scandals by highlighting common patterns among the cases. Both
police corruption and corporate crime deal with a similar underlying problem of the violation of
positions of trust and conflicts of interest. It is for these purposes of synthesis, pattern discovery,
and a focus on scandal and reform that an adaptation of Sherman’s (1978) work on police corruption in organizations will be used to analyze organizational deviance and fraudulent behavior among corporations and industries.

Figure 1 displays the model of scandal and reform. The conceptual framework starts with three criminological contexts that shape the scandal, including: 1) societal context, 2) political context, and 3) regulatory/control context. These contexts contribute to organizational deviance that can eventually lead to a scandal as defined by a societal reaction.

![Figure 1: Model of Scandal and Reform](image)

Once the scandal occurs, social control is mobilized, which includes sanctions through the use of criminal, civil, or administrative laws. The scandal is also used as a catalyst for the creation of reforms meant to address problems leading to the crimes. The four cases will be compared using the framework to uncover common patterns of societal reactions to major financial crimes.
Criteria for Interpreting the Results

Each part of Figure 1 will be applied to the four cases using cross-case synthesis to determine the commonalities that exist in each aspect of the scandal and reform model. Comparisons will be made using the collective data from all four cases. The results of the analysis will be displayed in a summary table showing the similarities discovered. A subsequent discussion in Chapter VI will examine policy alternatives based on the common patterns.

Using multiple cases and replicating the same analytical methods for each case will allow the original propositions to be reshaped to fit any case information that deviates from the model (Yin, 2009). The adaptive nature of the replication method allows for stronger relational conclusions to be drawn. If multiple cases support the propositions as demonstrated in the analytical model, replication can be claimed that will support the thesis propositions (Yin, 2009). The replications of the case study, as evidenced through the use of multiple cases, is similar to conducting multiple experiments in that an analytic generalization is made from the results to the broader theoretical propositions. If contradictions are found in the replications, the propositions need to be modified and the modified propositions should be retested with multiple cases (Yin, 2009). The major rival hypothesis is the lack of a clear and consistent pattern between the cases. By the time conclusions are drawn from the analysis, alternative propositions should be eliminated or acknowledged as weaknesses in the original propositions according to the results. The results of the analysis using the framework will be used to generalize the model of scandal and reform to subsequent cases of corporate and financial crime scandals.

Limitations

In order to answer the research questions of discovering societal responses and policy implications to major corporate and financial crimes, it was necessary to use a unique case study
research design with a framework for organizing the case data. The major limitation of the design relates to the generalizability of the findings to other crimes committed by corporations. These cases are specifically chosen for the profound damage caused to society on multiple levels throughout American history. Smaller scale cases not resulting in reform may fit with some parts of the model but not with others.

Another limitation of the design consists of studying corporate crime using a model originally developed to analyze police corruption. There are distinct differences among these two criminological topics that may complicate the transfer of the concept from one type of crime to another as police organizations are distinctly different from corporations. This thesis takes this issue into account by adapting the concept accordingly to reflect these differences and focusing on general patterns instead of attempting to achieve an exact replication of Sherman’s (1978) study. There is currently no accepted model for studying scandal and reform, and Sherman’s (1978) method provides a starting point for the analysis of this cycle in corporate crime.

The limited number of cases suggests the study lacks clear applicability to other forms of corporate crime. Only four cases of corporate crime were chosen from a multitude of cases that could be considered for pattern matching. This thesis takes this into account and is carefully designed using the replication of multiple cases to ensure the findings will be generalizable to similar cases. The ability of the propositions to be molded to fit the changing evidence provides validity to the design of this thesis and is a unique feature of the case study approach that enhances generalizability (Yin, 2009).

Each of the criticisms regarding generalizability can be attributed to all forms of qualitative research. All studies are limited to a certain extent and quantitative methods that
examine large numbers of cases are certainly generalizable to a greater degree than qualitative
studies. Quantitative methods are considered by many sociologists to be more representative,
reliable, and valid than qualitative methods due to the statistics used in the analytical process, but
this conclusion is shortsighted (Hamel, 1992). The move of criminological research toward the
overwhelming focus on quantitative methods has resulted in the loss of individual-level aspects
of crime. Methodology should not be subject to outright rejection of non-quantitative methods
of analyzing social problems. The case study approach is designed to acquire a large amount of
detailed information to describe a specific issue and can be applicable for the general patterns
discovered (Yin, 2009). Case studies are a practical way to apply the knowledge learned through
other methods to discover new ways of conceptualizing and comprehending problems.
Furthermore, the case study approach breaks through historical barriers limiting available data on
these scandals, instead allowing for the focus on discovering macro level patterns.

Conclusion

This chapter addresses the methodological issues related to this thesis. The study uses a
multiple case study design with replication to find common patterns between the four cases of
corporate scandal. A large amount of detailed information will be gathered on each case in order
to gain an intimate understanding of the various factors involved in the corporate scandals. This
data will be examined within the context of a framework outlining the general characteristics of a
cycle of organizational deviance, scandal, and reform. The goal will be to discover patterns
among the four cases of corporate scandal that can be used to shape policy and aid in the
prevention of future large-scale financial crimes. Chapter IV will provide a detailed case history
of each of the four corporate scandals, followed by the application of the logic model in Chapter
V.
CHAPTER IV.

CASE HISTORIES OF FOUR CORPORATE SCANDALS

This chapter will provide detailed narratives of case histories of four major cases of corporate crime. The four cases will be used in the remainder of the study to examine patterns found between these large-scale financial crimes. These cases include: 1) Cooke & Co. and Northern Pacific Railroad, 2) Insull Utility Holding Companies, 4) the Savings and Loan Industry, and 4) Enron.

*Cooke & Co. and Northern Pacific Railroad*

The first case is Jay Cooke & Co.’s risky venture into funding the Northern Pacific Railroad through the sale of securities. Speculation, government corruption, and project mismanagement would plague the construction of the railroad in an environment driven by the collusion of business and government entities. Economic power became concentrated in the hands of a few large corporations funded by many middle and lower class Americans. Eventually, the fraud involved in the Cooke case was revealed to the public and securities sales ceased. Panic ensured as Cooke & Co. closed its doors, resulting in a chain reaction driving many banks to insolvency. No individuals were prosecuted and reforms were largely ineffective in this nineteenth century example of financial crime.

By the middle of the 1800s, the United States was an undeveloped country compared to more advanced nations (Kirkland, 1961). The federal government was one of the largest consumers of agricultural and industrial goods (Kirkland, 1961). Businesses operated largely without governmental restraint, acting solely on the whims of the market. There was no government regulation or oversight of business activities, as profit and expansion were the primary focuses of both business and government (Geisst, 1997). The American economy was
constantly in a state of flux, as there was no stability in the US banking system. Between the
War of 1812 and 1840, four severe recessions damaged the economy. After the stock market
-crash of 1857, Wall Street further developed the ideology of survival of the fittest with a
predatory mindset focused on profit maximization (Geisst, 1997). Businesses raced against one
another to grow their corporations, increasing the potential for large profits (Skeel, 2005).

The Northern effort in the Civil War contributed to government innovation in business,
industry, and banking (Kirkland, 1961). In order to fund projects and build the infrastructure of
emerging American cities, governments issued securities to major financial institutions that
funded the majority of expansion projects at the time (Geisst, 1997). A national banking system
was created, allowing private corporations to issue US Treasury securities (Kirkland, 1961). The
federal banking focus restricted the securities activities of state and local banks (Geisst, 1997).
Governments issued their securities to corporations as a donation or in exchange for corporate
securities in order for railroads and canals to go through their settlement (Pinsky, 1963). They
were willing to allow public money to be used for private corporations because of the potential
benefits from corporate-run projects, particularly railroads. These innovations in securities
issued by governments meant that private corporations were given the ability to market state,
federal, and municipal credit while collecting the profits from the sales. Whether private
corporations received the profits from government securities or made a commission from their
sale, the lines between the state and rapidly growing corporations were blurred (Geisst, 1997;
Skeel, 2005).

Until the Civil War, most private American citizens did not own securities of any kind.
The need for continued financing to fund the war led to the authorization of government bonds to
be distributed for purchase by citizens. The job of selling securities for the federal government
would be given to Jay Cooke. Cooke was the founder of Philadelphia-based Cooke & Co. and had creative ideas on how to market government debt to ordinary citizens based on a patriotic support of the Northern war effort. Jay Cooke, a major banker of Philadelphia and the founder of Cooke & Co., developed a strategy for selling bonds to ordinary citizens motivated by a patriotic rallying cry. Cooke’s techniques included door-to-door solicitation, promotion of patriotism, and an advertising campaign in the media. Cooke was eventually hired in the US Treasury Department to sell government debt on a wide scale. He promised high returns and safety in personal investments and was able to significantly increase the market for securities investments by banks. Under his direction, the Treasury was able to raise over $830 million in securities (Skeel, 2005; Lubetkin, 2006).

The power vacuum left by the end of the Civil War and the assassination of Abraham Lincoln led to the influx of corporate lobbyists seeking to acquire power and wealth (Bowers, 1929). Wealthy investors became involved in railroads by buying large quantities of securities in order to gain a significant influence in the direction of the projects. Railroad directors took over segments of track and transported various goods and services, allowing them to charge high rates and generate large profits. The railroads as corporations also used their status as limited liability entities to amass large sums of money from shareholders. Shareholders were generally local merchants, farmers, and manufacturers who believed in corporate promise of financial security offered by railroad companies. The influx of money from the government, wealthy financers, and bonds allowed railroads to continue the rapid development of tracks across the country (Geisst 1997; Skeel, 2005).

Cooke & Co. would use Cooke’s strategy of selling war debt to finance the Northern Pacific Railroad (Skeel, 2005). Major financers and the government refused to financially
support the project due to the lack of major communities or regions it would connect (Lubetkin, 2006). In order to complete the project, Cooke decided to raise money for Northern Pacific solely through individual investors. Jay Cooke & Co. took commission on the bonds sold in stock rather than cash. This resulted in Cooke not only being the main underwriter of the loan for Northern Pacific but the majority shareholder as well (Lubetkin, 2006). This was unheard of at the time, as banks traditionally employed multiple institutions to spread the risk of major investments so that no one institution bore all the risk (Skeel, 2005). Cooke bribed public officials, including members of Congress and two vice presidents (Bowers, 1929). These political connections were exploited to gain land subsidies for Northern Pacific Railroad.

Conflict had existed within Cooke & Co. and the management of Northern Pacific that marked the whole project development. Distrust existed between those who were running Northern Pacific and those who were financing the project at Cooke & Co. The railroad was being inadequately constructed and Northern Pacific president Gregory Smith was accused of receiving unreported benefits and kickbacks from contractors (Lubetkin, 2006). Cooke’s closest confidants were telling the company leader the risks were too great to continue with the project (“Examination,” 1874; Skeel, 2005). Despite this, Cooke carried on financing Northern Pacific past the Missouri River, leading his partners to believe he had broken an earlier promise not to do so (Lubetkin, 2006).

By 1872, the future of Northern Pacific began to look questionable. Rumors of wasteful spending, fraud, and lavish lifestyles emerged surrounding many railroad projects at the time, including Northern Pacific (Skeel, 2005). These stories of corruption and bribery involving Cooke and others as well as stories of Indian attacks on Northern Pacific surveyors and workers began to surface in the media (Lubetkin, 2006). J.P. Morgan and Anthony Drexel, two other
major financers of the 1800s and rivals of Cooke, began to create doubt about Northern Pacific through Philadelphia newspapers financially controlled by their companies. It was portrayed as a speculative project that would not bring financial return for its investors (Skeel, 2005). Scandals involving congressional corruption along with Cooke’s public image problems led to the halting of the bond sales that financed the Northern Pacific Railroad (Lubetkin, 2006). One private report on the Northern Pacific indicated the “railroad was organized on a wrong basis; that the finance organization was entirely inadequate; that the scheme could never be carried out as projected, and nothing but disaster could result to those who had anything to do with the matter” (“The Panic,” 1873).

The shock of the corruption by Cooke eroded public confidence in the markets and the Northern Pacific Railroad (Gerding, 2006). Banks were losing deposits as securities sales dried up and investors began to withdraw their money at overwhelming rates. The assets of Jay Cooke & Co. were strongly linked to Northern Pacific and many unsold bonds that no longer interested investors. Even though the company was thought to be in good financial condition, Jay Cooke & Co. did not have the money to pay back all the bank depositors who were now withdrawing their investments (Skeel, 2005). On September 18, 1873, Jay Cooke and Co. suspended payments and the doors of the major office buildings in Philadelphia, Washington D.C., and New York were shut, leaving hundreds of angry depositors outside (“The Panic,” 1873). Panic and fear gripped Wall Street as securities values of all types declined (“The Panic,” 1873; Wicker, 2000). A chain reaction of bank, railroad, and business failures ensued between 1873 and 1875. Many middle and lower class farmers, merchants, and retirees would suffer as a result. The credibility and value of railroad securities was severely damaged as a general distrust of American securities ensued (“The Panic,” 1873). Unemployment reached over fourteen percent (14%) by 1876 as
the US slipped into a near decade-long depression, second in severity only to the Great Depression (Bowers, 1929; Lubetkin, 2006).

Many reforms of the railroad industry and the operations of corporations would come out of this scandal aimed at preventing speculative investment projects from damaging the American economy. Pennsylvania was one state among many to pass legislation limiting state credit that could be given to private corporations, prohibiting the state from being a part of internal improvements by private companies, and prohibiting financial aid from being given directly to corporations (Pinsky, 1963). This reform was successful in the states that implemented it from preventing private corporations from growing their business by risking state money and mandated that public money could only be put at risk if done so by a public entity. The Supreme Court also issued a decision that prohibited corporations from entering into contracts with their own managers. Notably, the majority opinion stated, “the same person cannot act for himself and at the same time, with respect to the same matter, as an agent for another, whose interests are conflicting” (Wardell v. Union Pacific Railroad, 1880, p. 658). The Interstate Commerce Act of 1887 created the Interstate Commerce Commission (ICC), which would force railroads to develop safety mechanisms and prevent discriminatory rates from being applied to different areas along a railroad route (Kirkland, 1961). Although later watered down by Supreme Court decisions and future legislation, these reforms came directly as a result of the corporate misconduct by Cooke and other railroads scandals of the late 1870s.

Railroad companies were among the first large American corporations that evolved into what would eventually become modern day corporate enterprises. Instead of simply operating according to the current conditions of the market, railroads began to act as business organizations with a hierarchical structure. The next generation of corporations examined in thesis is utility
holding companies. These corporations were even more complicated than the structure of the Cooke’s Northern Pacific financing, with similar political corruption, market speculation, and manipulative marketing techniques. Regulatory structures established after the Cooke case failed to prevent the scandal and the societal response fell short of fixing fundamental problems leading to corporate crime.

*Insull Utility Holding Companies*

The second case is the collapse of the Insull utility holding companies. Like Cooke, the concentration of corporate power in Insull holding companies created a house of cards dependent on continuous speculative investment. Insull took out enormous debt and failed to recognize signs of instability brought on by worsening economic conditions. The Insull scandal was one of the major contributing factors to the 1930s Securities Acts and other New Deal legislation. These reforms resulting from Insull were perhaps the most effective among the cases examined in this thesis at addressing conflicts of interest within the banking, securities, and utilities industries.

At the end of the 1800s, only wealthy individuals could afford electricity. Electricity companies each had their own lines, central power stations were rare, and small generators powered most buildings (Cudahy & Henderson, 2005). Major power companies at the time, preferred to focus on making an immediate profit by selling local generators than building central stations that could serve the general public (Munson, 2005). This business model changed in 1892 when Thomas Edison’s personal secretary, Samuel Insull, left the newly General Electric (Munson, 2005). He became president of a small, Chicago-based power company called Chicago Edison Company and secured power within the company by purchasing a large amount of stock (McDonald, 1962). Insull had a vast knowledge of both the financial
and technological aspects of the electricity industry, and used this to his advantage when competing with other power companies in Chicago (Cudahy & Henderson, 2005).

When Insull arrived in Chicago, more than thirty power companies in Chicago provided electricity for different buildings and streets from individual generators (McDonald, 1962). Streetcar companies would use their generators during morning and evening commutes when transportation levels were greatest and street-lighting companies only used their generators at night. Insull thought this was an incredibly inefficient and wasteful system that kept prices too high for the average American to afford electricity (Munson, 2005). Chicago Edison constructed the Harrison Street Station, which was the largest centralized power station in the world at the time (Cudahy & Henderson, 2005). Due to continuous operation, Chicago Edison was able to produce cheaper and more efficient electricity. A promotional rate system was introduced that charged lower prices to large energy consumers more likely to generate their own power if prices rose too high (Anderson, 1981).

Insull established an anti-competition philosophy within his companies in the quest for domination over the utilities industry. This attitude permeated the entire organizational culture of Chicago Edison, as salesmen were encouraged to undercut the prices of smaller companies. Insull blocked competition by establishing power facilities that restricted the ability of other companies to supply power to consumers. Insull also bribed politicians and streetcar companies to purchase power from Chicago Edison to become the sole issuer of electricity for several government-run transportation systems (Cudahy & Henderson, 2005).

Like Cooke, Insull focused on investments from private investors, mostly middle and lower class Americans. A massive advertising campaign was launched encouraging consumers to purchase new household products, such as refrigerators and water heaters. Electricity was
even marketed to children, who were seen as the power consumers of the future. Insull convinced many in the public about the advantages and security in electricity investments (Munson, 2005). The central marketing phrase highlighted the relative safety of investing in utilities: “if the light shines, you know your money is safe” (Cudahy & Henderson, 2005, p. 52). Insull securities contained guaranteed dividends for investors, which influenced many people to invest their money. This provided funding for Insull to buy other electric companies, even those much larger than his own (Bonbright, 1972; Munson, 2005).

Sustaining Insull’s increasingly complex utility structure required tremendous amounts of capital. Middle West Utilities was set up as a utility holding company. It controlled Insull’s expansion and absorption of smaller utility companies. The holding companies were a version of the modern corporation and allowed large amounts of capital to be raised for expansion. This holding company structure of interconnected companies required the continuous funding and expansion of the electricity industry to be sustained (Cudahy & Henderson, 2005).

The central goal of the Insull utility companies was to create a private monopoly over power distribution. Many municipal governments were purchasing small utilities companies to remove jurisdiction over electricity distribution from the control of private investors. Insull saw this movement as a threat to his corporation. He publicly opposed government control of electricity by citing the corrupt politicians who would assume control of the utilities industry (McDonald, 1962). Insull took a different approach than the other corporate crime cases in this thesis by advocating for the regulation of utility companies to counteract the movement toward public ownership. He argued that oversight and accountability of a utility company that had a monopoly on power distribution was a better approach because it would keep corrupt politics out of private business, drive prices down for consumers, and increase service quality (Munson,
2005). In reality, this perspective was merely a creative adaptation of the laissez faire mentality. Insull recognized it would be easier to manipulate one state regulator than to undergo scrutiny from hundreds of municipal governments. Insull in effect became one of the chief advocates of state regulation, which would allow him to maintain a legal monopoly over much of the utilities industry (Wasik, 2006).

Insull’s efforts paid off, as his companies grew immensely in the beginning of the 1900s. His achievements included:

- Chicago Edison customers grew from 5000 in 1892 to 200,000 in 1913 (Munson, 2005).
- Electricity sales increased twelve percent (12%) annually from 1900 to 1920 (Munson, 2005).
- Insull construction projects increased from $500 million in 1902 to $2 billion in 1912 (Munson, 2005).
- Overall costs to Insull customers went from twenty cents (20) per kilowatt-hour in 1897 to five (5) cents in 1906, and then two and one half (2.5) cents in 1909 (McDonald, 1962).
- Middle West expanded operations to four hundred (400) communities in thirteen different states (Cudahy & Henderson, 2005).
- Over thirty states developed commissions to regulate utility companies with centralized, monopoly control over distribution (Munson, 2005).
- The Insull conglomerate became owned by thousands of individual investors, with securities sales increasing from six thousand in 1921 to over one million by 1930 (Cudahy & Henderson, 2005).
Investors saw utilities securities as safe investments. Even the 1929 stock market crash did not hurt the utility holding companies (Munson, 2005).

The seeds of Insull’s downfall were planted when a private investor named Cyrus Eaton began to buy large amounts of Middle West securities. Insull became fearful of losing control of his corporation to an outside investor and created Insull Utility Investments (IUI) in order to insulate his companies from a possible outside takeover (Munson, 2005). This created a new layer of holding companies on top of the pyramid of companies that already existed and were controlled by Insull (Cudahy & Henderson, 2005). Insull then created Corporation Securities of Chicago (Corp), which was another holding company that was used to purchase shares of stock in IUI. Each holding company owned stock in the other, with Insull managing both companies. However, the actual number of power generating utility companies in the conglomerate was decreasing while the holding companies were rapidly growing.

Other areas of the country without as high quality of service as in those served by Insull’s companies were starting to demand more reasonable access to affordable electricity (Cudahy & Henderson, 2005). The newspapers circulated stories accusing holding companies of charging inflated and excessive rates for electricity. The debate between public and private ownership turned in favor of government control, as many lobbied against the powerful holding companies that controlled the utility industry.

After the stock market crash, utility companies maintained strong financial grounding due to the consistent demand for electric power. However, holding companies that were providing investments based on utilities did not enjoy the same level of stability. Insull did not change business practices to reflect the country’s plummeting financial market, as he continued to spend money and invest in the holding companies (Munson, 2005). He began to issue dividends in
stock instead of cash in order to retain enough capital to continue expansion. Similar to fundraising problems that led to Cooke’s downfall, the holding companies began to lose revenue as investment and expansion slowed. Insull reassured investors and company employees that the financial condition of the companies was sound. He then took out $20 million in additional loans from J.P. Morgan to purchase $56 million in IUI securities owned by Eaton (Cudahy & Henderson, 2005). Insull’s holding companies were now at risk of being overtaken by J.P. Morgan and other large financial firms, as his companies had been offered as collateral for the loans he took out in a desperate attempt to maintain control (Munson, 2005).

When Insull could no longer make the interest payments on his loans, New York bankers appointed accounting firm Arthur Anderson to audit the holding companies. Insull was previously able to manipulate auditors to gain favorable reviews of his financial records, but did not have the same leverage over Anderson. Anderson reexamined the bookkeeping methods of Middle West Utilities and discovered the company was insolvent, having been profitless for years and funded entirely by IUI and Corp investors (Cudahy & Henderson, 2005). When news of the valueless utility companies became public, Insull was forced to resign from all of his leadership positions as investors to sell their securities. The total value of Insull investments dropped over $150 million over the course of one week in September 1931. The value of Insull’s securities fell from $570 per share to $1.25 per share. The shareholders in IUI, who were mostly middle and lower class Americans, lost all of the investments they had been led to believe were safe and financially sound. Total shareholder losses were estimated at over $750 million (Wasik, 2006).

The newly created Securities and Exchange Commission (SEC) subsequently opened an investigation into the holding companies, citing accounting irregularities, asset value inflation,
and securities misrepresentation (Munson, 2005). When the collapse of his companies was eminent, Insull signed off on all of his presidencies and directorships and left the United States for Europe. Criminal indictments were issued for embezzlement, fraud, and larceny but unable to be carried out until Insull was later apprehended and brought back to the United States from Turkey (Cudahy & Henderson, 2005). Insull maintained his innocence from intention wrongdoing, stating he had made mistakes in underestimating the financial condition of American securities but did not purposely defraud any of the investors (“Insull is,” 1934). In a subsequent criminal trial, Insull and his co-defendants were acquitted of all the charges against them (“Insull Acquitted,” 1934). Both federal and state prosecutors again attempted to convict Insull in the months to follow but were unsuccessful and Insull completely escaped criminal penalties (Cudahy & Henderson, 2005).

The New Deal legislation rested on the assumption that ‘big business’ was unable to be effectively regulated by the states and Insull had swindled the American people with a complicated financial system of holding companies (Cudahy & Henderson, 2005). The laws passed included the Securities Act of 1933 and the Securities Exchange Act of 1934 to govern securities and the Public Utility Holding Company Act of 1935 and the Federal Power Act of 1935 to regulate the utilities industry. The legislation that dealt with this crisis led to an era of stability in electric energy distribution. Energy was distributed in a highly uniform fashion that ensured consistency and reliability. Utilities retained a monopoly over certain geographic areas. A utility had guaranteed profits and took full responsibility for upkeep expenses and power generation from central power stations (Van Niel, 2009). These business models for natural gas and electricity distribution, though not without inefficiencies and pitfalls, became the standard
for providing reliable energy. This would be the case until deregulation of the industry began in
the 1970s, eventually contributing to the Enron scandal.

The New Deal policies took aim at the multiple factors contributing to the Great
Depression. Unlike the Cooke case where few large-scale issues were addressed, the Insull
reforms made several attempts to address concentrated corporate power and conflicts of interest.
The S&L crisis resulted in billions lost as ordinary Americans suffered from the reckless
speculation of the elite, just as in the Cooke and Insull cases.

*The Savings and Loan Industry*

Countless insolvent institutions in the S&L crisis led to billions of dollars in taxpayer
losses due to industry wide fraud produced by deregulation and risky investments by thrift
owners. Taxpayers were forced to pay for the damage as top executives at S&L institutions took
risks on speculative projects for personal profits. While the Cooke and Insull cases took place in
environments largely free from regulation, restrictions on the S&L industry were removed in the
80s. Regulators were marginalized due to growing political pressure to allow the free market to
operate unrestricted. The scandal resulted in a focus on individual sanctions and an ineffective
reform that mitigated damage but failed to address the speculation and deregulation at the center
of the problem.

The modern savings and loan (S&L) industry has roots in the Great Depression goal of
promoting investment and housing construction. Also known as ‘thrifts,’ S&Ls issued home
loans and promoted habits of thrifty savings among its members (Mason, 2004). S&Ls allowed
local individuals to pool their money together and issue long-term loans with fixed interest rates
(Mason, 2004). S&Ls were primarily regulated by the states, with the federal government not
being directly involved with local S&Ls (White, 1991). S&Ls, commercial banks, insurance
companies, and mutual savings banks were the primary sources of home loan financing (Mason, 2004).

The collapse of many thrifts and banks during the Great Depression led to federal legislation focused on stabilizing the financial system. This was the beginning of federal regulation of the S&L industry, which established rules for the types of products thrifts could issue. Many thrifts and banks had collapsed due to risky, speculative investments that never produced money (White, 1991). The Federal Home Loan Bank Act of 1932 established the Federal Home Loan Bank Board (FHLBB), whose focus was to ensure the constant flow of credit in the financial market by both regulating and insuring deposits issued to federally chartered S&Ls. As the primary issuer of mortgage loans to middle and lower class Americans, the S&L industry was thought to be a key component to promoting homeownership (Immergluck, 2009). Government regulation and the support of fixed-rate loans stabilized mortgage financing by limiting the risk involved with many types of variable-rate loans that did not offer fair terms to borrowers (Immergluck, 2009). It allowed for thrifts to have either a federal or state charter, with only federally chartered thrifts being insured by the FSLIC (White, 1991). Thrifts were able to choose which level of government they chose to charter with based on how favorable the terms of the agreements fit with the goals of the particular institution. This new system would provide a method of funding for local thrifts to keep credit flowing and allow the institutions to continue lending money to consumers (Immergluck, 2009).

The once thriving S&L industry began to lose money in the 1970s due to changing economic conditions and priorities. Investment focuses shifted away the safety of S&Ls toward the securitization of mortgage assets by large commercial and investment banks (Immergluck, 2009). Competition was increasing and investors were being drawn to other financial institutions
that offered products with higher risks but greater opportunities for profit. The worth of the industry decreased from $16.7 billion in 1972 to a negative $17.5 billion in 1980 (Calavita & Pontell, 1990).

The movement toward deregulation was ushered in with the election of Ronald Reagan, who was famous for stating in his first inaugural address that “government is not the solution to our problem; government is the problem” (Miller Center of Public Affairs, 2010). This laissez faire political philosophy would permeate throughout the 80s and 90s. Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St. Germain Depository Institutions Act in 1982. Both acts were designed to help the struggling S&L industry by loosening restrictions and allowing them to compete with other financial institutions. The philosophy behind the new laws was to allow the free market to function without government restrictions that impeded on the creativity and productivity of capitalist enterprise. Interest rate limits thrifts could charge for savings and loans were gradually removed. These regulatory changes were in part due to political corruption as evidenced by the nearly $9 million in campaign contributions, personal gifts, and entertainment given to the Congressional Banking Committees members by the S&L industry between 1985 and 1990 (Waldman, 1990).

As a result of federal deregulation, state regulatory agencies also began to deregulate the thrift industry. State and federal governments both regulated S&L institutions, but individual S&L charters were created with either state or federal regulators. Regulatory agencies received their funding from the institutions with charters from institutions they regulated. The new lax federal rules were more attractive to thrifts than many state regulations, which resulted in many state-chartered S&Ls changing over to federal charters. In order to keep funding from financial
institutions and continue operations, many states needed to reduce their strict regulations on the thrift industry and provide better deals than the federal government (Calavita & Pontell, 1990).

Two trends among state-regulated thrifts resulted. First, regulators began to allow brokered deposits with a middleman who negotiated expensive deals for a fee. These deposits increased to over four hundred percent (400%) of an institution's total assets from 1982 to 1984 and typically involved high interest rates. Second, a single person could now own the majority of an S&L institution. On top of this, Congress required the FSLIC to insure all savings and loan deposits without specifying the conditions in which institutions could issue loans (Calavita & Pontell, 1990).

The deregulation of the S&L industry created new opportunities for misconduct. In order to remain solvent, the industry issued riskier loan products without having to consider the potential consequences of their actions. Thrifts offered ‘liar’s loans’ without down payments, and with adjustable interest rates, with the goal of attracting new business (Calavita & Pontell, 1990). Struggling thrifts immediately gained large amounts of cash from new financial products, and started issuing high interest rate loans and competing for deposits. The S&L industry expanded rapidly, increasing assets from $140.8 billion in 1982 to $282.9 billion in 1985 (White, 1991). These institutions now had more cash flow and assets, but had simply become larger problems than before due to their increased debt and decreased stability. Many of them went much further by speculatively making deals on projects. Since the FSLIC insured deposits, thrifts did not have to be concerned with the risks of their transactions and sought only to achieve short-term profit (Calavita & Pontell, 1990).

S&L leaders began to engage in fraudulent activities, dodging regulations that still existed in order to save institutions struggling to stay afloat. Others simply looted their own
institutions, embezzling money through insider trading, third party deals, excessive compensation, and inflating property values for profit (Calavita & Pontell, 1990). The opportunities for short-term profit brought the S&L industry a gold mine for profiteers looking to make quick money, which attracted new criminal activity to the industry (White, 1991; Calavita & Pontell, 1990). Institutions covered up their actions by manipulating financial records to create false impressions that the institutions were financially sound when in reality they were struggling to remain solvent (Calavita & Pontell, 1990). All the while, regulatory agencies were powerless to investigate and prosecute these crimes due to the anti-regulatory political climate and lack of resources to properly address the problem.

By the time the mistakes of failing to provide oversight were realized, the damage had already been done. The Tax Reform Act of 1986 eliminated tax incentives for real estate investment (Federal Deposit Insurance Corporation, 2007). Instead of easing the condition of S&Ls, the legislation led to the rapid downfall of unstable thrifts. S&L institutions declined rapidly during this crisis period: S&L loans went from fifty-eight percent (58%) of all outstanding mortgage debt in 1973 to twenty-six percent (26%) in 1989, and to fourteen percent (14%) in 1995 (Immergluck, 2009). The risky loans S&Ls had issued eventually led to the collapse of over one thousand thrifts and total losses estimated at $519 billion by 1995 (Curry & Shibut, 2000). By the time the scandal had subsided, the entire S&L industry had lost $29.1 billion in total wealth (Curry & Shibut, 2000).

In 1987 and 1988, 11,319 cases of S&L failure were investigated by the Department of Justice for possible fraud (Calavita & Pontell, 1990). Due to FSLIC insurance on deposits, the government was required to pay for losses to individual savings and investments (White, 1991). This was the first so-called ‘bail-out’ by the federal government to ease losses caused by the
careless actions of those in the private sector. During this time, the estimated total combined cost to both the public and private sector by 1999 was $152.9 billion with U.S. taxpayers paying $123.8 billion (Curry & Shibut, 2000). An estimated eighty-percent (80%) of failed S&Ls involved some level of crime and fraud (Calavita & Pontell, 1990). The crimes in the savings and loan industry were on an unprecedented level. It became the largest financial crime case in history until the sub-prime mortgage default crisis thirty years later.

A reform effort aimed at cleaning up the industry came in the form of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIERRA). FIERRA abolished the FSLIC and established the Resolution Trust Corporation (RTC) to handle failed thrifts. The RTC was intended to be a temporary organization, but was extended until 1995 due to the overwhelming number of S&L failures. At that point, the duties of the RTC were transferred to the Federal Deposit Insurance Corporation (FDIC) (Curry & Shibut, 2000). While FIERRA provided a means to mitigate the damage caused by S&L failures, it did not address the culture of deregulation or the increased focus on speculative Wall Street investment banking.

The focus on speculative securities speculation ties the S&L case to both Insull and Cooke. Middle and lower class investors primarily felt the effects of the collapse of the S&L, Cooke, and Insull bubbles. Similarly, the Enron case also led to wide-scale harm for middle and lower level employees and stockholders to the benefit of top executives. Enron was characterized by securities fraud, accounting misrepresentation, and deregulation of the natural gas and energy industry established after Insull’s collapse. Like the S&L scandal, Enron illustrated the eminent damage resulting from diminished regulations and ineffective social control mechanisms.
Since the reforms of the Insull scandal, energy distribution had been a highly regulated industry. The 80s deregulatory attitude that affected S&Ls also affected the energy industry and contributed to the Enron scandal. Enron used similar complicated financial structures as Cooke and Insull, taking speculative risks to inflate stock values. The company failed to accurately portray its finances and manipulated regulators to deceive investors. Enron became a symbolic representation of corporate abuse due to the unprecedented level of accounting, securities, and consumer fraud perpetrated by the one-time leader of the energy trading market.

Government regulations began to disappear with the passage of the Natural Gas Policy Act in 1978, which allowed consumers choose among multiple gas suppliers instead of being locked into a contract with a single distributor (Van Neil, 2009). These brokers and agents became middlemen in the distribution chain by negotiating deals between consumers and suppliers and arranged for the transportation of natural gas to consumers. The Energy Power Act of 1992 resulted in similar structural changes in electricity distribution, as third-party entities were permitted to purchase blocks of wholesale electricity from power generators and redistribute it to local companies (Van Niel, 2009). The goal was to eliminate restrictions on the movement of electricity between regions and states to create more efficiency in the distribution system, thus driving costs down. This brought new third party entities into the energy industry in search of easy money, similarly to the influx of profit-seekers among S&Ls after the industry was deregulated.

Enron emerged in 1985 and became the first interconnected natural gas pipeline (Healy & Palepu, 2003). Kenneth Lay became the Chief Executive Officer (CEO) and Chairman of the new corporation (Van Niel, 2009). Lay sought to expand Enron’s operations by changing the
way energy was supplied. Deregulation of the natural gas markets permitted greater flexibility in the setting of prices and creation of business relationships. Enron executives began to participate in the unregulated energy industry by trading financial contracts instead of physically owning assets and supplying energy to distribution centers (Van Niel, 2009). Enron also began to purchase other energy companies, pipelines, broadband fiber optic cable lines, and electricity plants to control major sectors of the distribution chain under the leadership of Chief Operating Officer (COO), Jeffrey Skilling (Healy & Palepu, 2003; Van Niel, 2009). The strategy of increasing control of distribution and participating in energy trading gave Enron an opportunity to siphon off energy legally to store and sell the supply with long-term contracts at higher rates (Skeel, 2005).

The complexity of Enron’s business dealings revolved around a maze of accounting strategies used to disguise the financial condition of the corporation. The two accounting issues central to Enron’s activities were mark-to-market accounting and the use of ‘special purpose entities’ (SPEs). Mark-to-market is a type of accounting that allows transactions to be recorded on the basis of projected future earnings instead of actual, immediate earnings (McLean & Elkind, 2003). Instead of listing the actual prices of buying and selling natural gas, Enron listed projected profits of various long-term contracts made with third party entities (Healy & Palepu, 2003). Enron could make projections of the potential earnings of future projects and record profits even if the project actually lost money. For example, Enron spent a billion dollars building a power plant in India, even though the country’s citizens could not afford to pay for the power the plant produced. Though it lost over a billion dollars on the project, Enron recorded $20 million in earnings (McLean & Elkind, 2003).
With Enron’s losses being portrayed as profits, a method was needed to eliminate debt from the financial records as well. Enron’s Chief Financial Officer (CFO), Andrew Fastow, developed a series of special purpose entities (SPEs) used to redistribute Enron’s debt (Van Niel, 2009). These SPEs were essentially shell corporations not included on the company’s balance sheets that were used to finance Enron’s transactions. Fastow was both the CFO of Enron and the manager of the SPEs, which gave him insider knowledge of the financial dealings of the companies and allowed Fastow to personally profit from the transactions. Enron assumed most of the risk from the projects the SPEs were developing, so the debt should have been reported on Enron’s balance sheets (Van Niel, 2009). However, the SPEs were used to hide the growing debt and cash losses Enron had been enduring, creating an artificial public impression that the company was financially sound. By 2001, Enron had hundreds of SPEs that were being used to fund long-term contracts at fixed rates with the debt not reported and artificial profits recorded in Enron’s financial records (Healy & Palepu, 2003).

Another major flaw with Enron’s corporate structure was grounded in executive compensation. Many top officers and executives were paid in stock options instead of cash (Coffee, 2002). These options, reportedly intended to attract top talent and align the interests of shareholders and managers, created an incentive for executives to drive prices up in order to make personal gains. There were few restrictions on how these stock options were exercised, making them a vehicle for profit through the artificial inflation of stock prices (Healy & Palepu, 2003). Enron’s stock prices increased from $19 a share in 1997 to $40 in 1999, then jumped to $90 in August 2000 (Windsor, 2009). Enron executives inflated the value of the corporation’s stock, and then cashed in their options for multi-million dollar profits (McLean & Elkind, 2003). The true value of the options was hidden from investors by not claiming them as expenses in
financial statements, which further disguised Enron’s overall debt (Van Niel, 2009). These
decisions led to the focus on short-term profits for increasing stock price instead of sustaining the
long-term stability of the corporation.

The true nature of Enron’s business model was largely hidden from investors, who did
not ask questions about the financial transactions Enron was making. Investors generally seemed
content with believing the remarkable performance of Enron’s expansion strategy would
continue, even though the nature of how Enron made its money was not readily apparent (Healy & Palepu, 2003; McLean & Elkind, 2003). Enron did not provide complete financial statements
to investors, failing to produce basic accounting items such as balance sheets, income statements,
and cash flow statements. This misinformation influenced the decisions of investors, analysts,
and creditors who rely on financial statements to issue credit and rate the quality of investments
(Van Niel, 2009). The lack of scrutiny by investors was compounded by the lack of
accountability and the failure of external control mechanisms.

Several key evaluation and rating entities that were supposed to be objective evaluators
of financial and trading practices helped to create the Enron illusion. Their failure to undergo
evaluations of Enron effectively condoned fraudulent accounting methods used to manipulate
stock values. The SEC failed to closely audit Enron’s financial transactions and was unable to
uncover the accounting irregularities (Van Niel, 2009). In fact, the SEC had examined Enron’s
potential use of mark-to-market accounting rules and had legitimized Enron’s subjective and
speculative profit estimations (McLean & Elkind, 2003). The SEC also reduced their
observation of the actions of major accounting firms. This, along with other legislative changes
that weakened securities fraud violations, decreased the liability of auditing agencies (Coffee,
2002).
Enron’s auditing firm, Arthur Anderson, was able to perform both auditing and consulting services for Enron. In 2000, Enron paid Anderson a total of $52 million, half for auditing and half consulting (Van Niel, 2009). This presented a conflict of interest for Anderson, as the threat of losing Enron as a client would have left the firm in dire need of other clients to maintain their businesses (Coffee, 2002). If Anderson had revealed Enron’s true financial condition, Anderson could have been let go as the auditor, bringing scrutiny from the public and a potential investigation from the SEC (Coffee, 2002). Auditors had relinquished their reputations for honesty and integrity for short-term profits.

Finally, financial analysts contributed to Enron’s deceptive condition by rating Enron’s stock with a strong buy rating. Even after accounting irregularities had been made public in October 2001, Lehman Brothers and Merrill Lynch both rated Enron stock as having a strong buy recommendation (Healy & Palepu, 2003). Enron paid a more than $125 million in fees to these and other investment banks from 1998 to 2000, creating a conflict of interest that affected the banks’ evaluation of the soundness of the corporations’ stock.

By 2001, the Enron’s true financial condition began to emerge. As new projects failed, Enron executives found it hard to make the corporation appear profitable. On August 14, 2001, Skilling announced his resignation as CEO and President of Enron, having taken over the position from Lay just six months earlier (Oppel & Berenson, 2001). Lay resumed control of Enron and cited personal reasons for Skilling’s resignation (Windsor, 2009). Lay tried to reassure investors and employees, stating the company was financially strong. At the same time, Lay and other top executives were selling their stock options. The retirement accounts of line-level employees were frozen as the stock price dropped, and the life savings of investors slowly deteriorated (McLean & Elkind, 2003).
Enron reinstated financial earnings from the overvalued profit projections that had been made for several years on projects that never made profits. Losses of $618 million were reported in 2001, with newly disclosed debt valued at over $3 billion and profits decreased by over $600 million (Windsor, 2009). Arthur Anderson destroyed physical evidence related to Enron, destroying over one tons worth of legal documents (McLean & Elkind, 2003). By November 29, 2001, credit rating agencies had reduced the value of Enron securities to junk status (“The Markets,” 2001; Windsor, 2009). On December 2, Enron filed for bankruptcy and tens of thousands of employees lost their jobs. Investors, creditors, shareholders, and employees of Enron were severely harmed by the collapse, with many who had invested their entire retirement portfolio in Enron stock losing everything (Oppel & Sorkin, 2001; Windsor, 2009).

After the collapse of WorldCom several months later, there was general recognition that these scandals were not isolated incidents. Confidence in the stock market eroded as investors became more aware of the risks of being defrauded (Gerding, 2006). The Sarbanes-Oxley Act of 2002 was aimed directly at retroactively addressing the Enron misconduct (Skeel, 2005). President George W. Bush, upon signing the Sarbanes-Oxley Act, called it the “most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt” (Bumiller, 2002). The laws were designed to increase the accountability of corporate executives, accountants, and securities analysts that contributed to the Enron scandal (Skeel, 2005).

Many Enron executives were charged under federal law and either were convicted or plead guilty, including Fastow, Skilling, and Lay¹ (“Enron Scorecard,” 2007). Skilling was sentenced to 24.3 years in prison and Fastow plead to six years for conspiracy (“Enron Scorecard,” 2007). Accounting firm Arthur Anderson was found guilty of obstruction of justice.

¹ Lay’s sentence was commuted when he passed away before the sanction could be carried out.
for shredding thousands of Enron-related documents. The many facets of corporate abuse perpetrated by Enron make it a unique case study for understanding business crime.

These four scandals in this chapter resulted in substantial losses to investors and taxpayers. The cases provide a historical perspective to the development and continuance of financial and corporate criminal scandals and began to illuminate commonalities between them, despite the differences in the industries involved in the scandals. They illustrate that financial scandals can occur in any industry under a variety of circumstances. The societal costs of these scandals may never be fully known, but clearly extend further than the immediate monetary losses resulting from the initial scandal. In order to gain a better understanding the commonalities among these cases, Chapter V will analyze them collectively using the logic model of scandal and reform.
CHAPTER V.

ANALYSIS AND FINDINGS

This chapter applies the methodology described in Chapter III using the four cases of corporate crime scandals described in Chapter IV. The analysis focuses on finding common patterns among the four cases. Sherman’s (1978) methodology for examining scandal and reform in police organizations will first be explained. This will be followed by an analysis of the different components of the logic model in Figure 1, including 1) criminological contexts, 2) organizational deviance, 3) scandal, 4) social control, and 5) reform.

Sherman’s Study of Scandal and Reform

Sherman (1978) began his analysis with a history of the individual police departments involved by identifying the environment and resources of the organization as two of the aspects involved in organizational deviance in police departments. He detailed the deviant goals of the organizations, the means used to commit the crimes, and the methods used to conceal information about the criminal behaviors. Sherman (1978) went on to explain that in order for deviant behavior to be addressed, social control mechanisms must be enacted. According to his analysis, major scandals are necessary in order for social control to be mobilized due to many effective obstacles to social controls being evoked in organizations. A scandal can be used as social control due to the public discovery of the deviant behavior that evokes a sense of outrage among citizens. Scandals are characterized by public anger, a surprise reaction to the deviance, and a sense of betrayal on behalf of citizens due to a breach of faith by a person in a position of trust. Scandals are organizational in nature, meaning that the culture of the organization led to the social harm done and no one individual person is solely responsible. Social controls result in
an investigation into the nature of the scandal and subsequent punishment of those involved through organizational sanctions, individual sanctions, or both (Sherman, 1978).

Policymakers also responded to the scandal by initiating reforms aimed at addressing the various factors that led to the scandal in an attempt to curb future deviant behavior. One such set of reforms included internal policies within a department, such as tightened supervision, internal accountability, and elimination of policies that encourage corrupt behaviors. These preventive controls also involved changing the external environment surrounding the organization, including eliminating the ability of officers to participate in corruption, such as bribery. Another type of reform involved changing the political environment surrounding the organization in order to reduce opportunities for corruption (Sherman, 1978).

Sherman (1978) concluded that the key to reducing organizational deviance was effective reform concentrated on the underlying conditions causing the corruption, eliminating opportunities for deviance, and encouraging the organization to make internal reforms that allow the organization to be effectively controlled from within (Sherman, 1978). This same concept will be adapted and applied to the four corporate scandals. The logic model will be followed using cross-case synthesis to apply each piece of the model. Figure 2 provides an overview of the findings.

Criminological Contexts

Criminological contexts provide the basis for the examination of deviance in the four scandals. These contexts shape the discussion surrounding the cases and provide a framework for analyzing the contributing factors to the organizational deviance, scandal, and subsequent reform efforts. The contexts that will be examined include: 1) societal context, 2) political context, and 3) regulatory/control context.
Common Characteristics Found in Cross-Case Synthesis

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<th><strong>Scandal</strong></th>
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<td>- Lack of regulatory resources</td>
<td>- Deception and manipulation</td>
<td>- Collapse/insolvency/bankruptcy</td>
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<td>- Business and stock market speculation</td>
<td>- Laissez-Faire/deregulation</td>
<td>- Failures of other control mechanisms</td>
<td>- Complicated facts</td>
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Figure 2: Cases Applied to Model of Scandal and Reform

*Societal Context*

The societal context will include an examination of the immediate environment surrounding the scandal. This includes the physical, social, and economic factors involved in precipitating the scandals. The common factors found among the cases include 1) movement toward concentrated corporate power and 2) business and stock market speculation.

*Movement Toward Concentrated Corporate Power*

The centralization of power in corporate form is a main theme driving each of the corporate crimes examined here and allowed the summation of tremendous wealth in the hands of a few at the expense of other smaller businesses. The economic and physical changes found in the four cases contributed to the growing movement toward concentrated corporate power in
the hands of a few elite corporations. The creation of a national banking system in the Cooke case led to the growth of large, Wall Street banks at the expense of smaller local and state banks by only allowing certain federal securities to be sold at nationally chartered banks (Geisst, 1997). Insull centralized power of utilities companies in Chicago and other areas around the country by using the holding company structure and charging lower rates to large industrial consumers of electricity through central power stations (Cudahy & Henderson, 2005). This resulted in once independently operated utilities to collapse under the weight of more powerful holding corporations, giving a monopoly over certain regions of the industry to a small number of owners like Insull.

The increased promises of high yield returns by commercial and investment banks threatened the stability of smaller, more local thrift institutions. This forced the more decentralized S&L industry to move toward federal charters and find new ways to remain competitive that were often more harmful than helpful. Enron promoted deregulation as a way of increasing competition, but the true motive was to enhance the company’s knowledge and power base in energy trading to take over smaller companies and increase profits through domination of the industry. Enron executives knew that by advocating changes in regulation and expanding to unknown markets, the company could continue to grow and control different areas of the energy industry to make profits. Unchecked fraud in these four cases led to spurious wealth concentration, eventually triggering a bubble collapse.

*Business and Stock Market Speculation*

The societal contexts involved increased reliance on speculative securities through the lens of optimism toward the stock market. Corporations in all the cases consistently felt pressure to increase their stock value, often resorting to fraud in order to meet unrealistic Wall Street
projections (Sweeney, 2003). Organizational cultures were taken over by social pressures to constantly increase profits. Stock values were inflated to make companies appear healthy and to allow executives to cash in stock options to make enormous profits. While speculation and risk are not inherently bad, companies that do not produce real goods or services pose speculative hazards.

Cooke & Co. followed what was characteristic of many other financers at the time by raising money on the speculative Northern Pacific Railroad when there was no guarantee the project would be profitable. “Overtrading, expansion of credits, rash investments, and unreasonable speculation on the part of those who thought it good to be rich, all enter into the explanation of the collapse” (Bowers, 1929, pp. 408-09). Many bankers grew their wealth by recognizing the structural gaps in the American financial system and exploiting those holes for personal gain (Geisst, 1997). New railroads, docks, and canals were wastefully and criminally constructed with tremendous amounts of capital and no immediate returns (Bowers, 1929). The Insull scandal occurred in this same type of context, as 1920s stock market speculation created a breeding ground for securities fraud. The constant expansion of utilities pushed prices down for many, but the expansion was built on an unstable house of card. Insull would weather much of the early effects of 1929 crash, but failed to take into account the seriousness of the depression. He took on more debt than could be paid back before finally collapsing in 1932.

The S&L crisis occurred within the context of a floundering 70s economy and 80s investment banking speculation. The S&L industry suffered from the increased investment in nondepository investment banking institutions that offered higher rates of return. S&Ls later became involved in many of these speculative investments. The societal context of the Enron case followed this same pattern of speculation. Fraudulent reporting of financial conditions to
inflate stock prices replaced disciplined business and accounting practices in many well-known and powerful corporations (Cunningham, 2003). Economic expansion was largely due to fraud that hid the true values of securities (Rockness & Rockness, 2005). For Enron, failed ventures into broadband, weather trading, and energy trading ventures covered up by accounting manipulations eventually led to the downfall of the company. The next section examines the political forces shaping this power concentration and speculation.

**Political Context**

The political context explores the pressures and influences of outside entities that encourage specific actions by organizations. These can include local, state, national, or international political forces that contribute to the development of deviant behavior. Legislative actions have brought about changes in behavior that have facilitated and encouraged illegal and unethical behavior. The focus here will be on 1) political corruption and state crime, and 2) laissez-faire/deregulation.

**Political Corruption and State Crime**

Political corruption and state crime contributed to the environment surrounding the four scandals. The government played a major role in the expansion of railroads by issuing tax exemptions and land grants to corporations. Political corruption was at the forefront of financing the railroads, many of which were funded by large banks like Cooke & Co. The focus on national banking led to private corporations being able to handle public money and market government securities without restraints on how the funds were managed. The development of the railroad system in the 1800s would not have occurred without the issuance of government subsidies, but government involvement also contributed to wasting public resources. This led to an economic depression after the collapse of Cooke & Co. Similar political involvement in the
Insull case contributed to continuing expansion despite an ailing economy. In the wake of the 1929 stock market crash, politicians and industry leaders worked together to reassure the public of the soundness of the financial system. President Herbert Hoover urged prominent businessmen to continue spending, keep their current employment count, and promote the soundness of the failing market (Wasik, 2006). Insull took this perspective to heart and continued acquiring debt despite the deepening depression. This mentality led Insull to overextend his finances, which eventually led to the demise of his unstable holding company structure.

The S&L case involved government involvement that weakened regulations on the thrift industry, making it easier for wide-scale fraud to occur. While the agenda of lawmakers and industry members did not appear to support fraudulent behavior and an eventual government bailout, the policies that were created in the context of the larger economic shifts directly enabled corporate crime that benefited thrifts and their executives (Glasberg & Skidmore, 1998). Corporate lobbyists in the Enron era became the largest contributors to political campaigns and sought to further deregulate and limit the powers of existing regulatory agencies (O’Brien, 2005). Securities issuers had influenced policymakers to limit the liability of the accounting industry for fraud and prevented attempts to restrict the non-audit services that firms could offer (Rockness & Rockness, 2005; Gerding, 2006).

*Laissez Faire/De-Regulation*

Laissez faire dominated the context of these cases. Proponents of laissez-faire argue that industries are best left to be self-regulated, thus preventing effective government oversight. The Cooke case was unique due to the absence of an established regulatory structure. Railroads were able to operate in an environment free from regulation and government oversight due to the
focus on economic expansion and wealth creation in post-Civil War reconstruction. Corporations were able to gain and maintain control over certain areas of industry, and they went unchallenged until the first progressive era. The political context surrounding the rise of Insull was characterized by a laissez faire stance toward business. The push for public ownership of utilities companies was fought off by industry leaders like Insull who exploited the political corruption of local Chicago government officials as justification for keeping utilities companies out of public control (McDonald, 1962; Anderson 1981). The Insull case differs from the others in that instead of pushing for deregulation, industry leaders supported state regulation because they knew monopolies would give them control over certain areas. Oversight from a single state regulator would be easier to manipulate than multiple municipal governments. Many progressive leaders were in favor of these regulatory changes to utilities, not understanding the implications of allowing holding companies to own other utilities companies across state lines (Lubetkin, 2006).

The S&L crisis began with deregulation. An anti-regulatory political attitude took over Washington and was solidified by the Reagan Administration. Congress removed regulations and allowed thrifts to participate in riskier speculative investments (Glasberg & Skidmore, 1998). S&Ls could legally gamble without risk because the FSLIC required the government to pay for depositor losses. While deregulation was designed to allow the struggling S&L industry to compete with commercial banks, it also opened the doors to the issuance of risky loan products (Calavita & Pontell, 1990). The political environment of the 1990s was similar to that of the 80s in that it catered to the interests of large corporations and securities issuers at the expense of investors and the integrity of the financial system. The prevailing wisdom was to allow the free market to operate without government restrictions. Enron not only benefited from
deregulation, but Enron executives Ken Lay and Jeff Skilling were some of the chief proponents of deregulation on the national stage (McLean & Elkind, 2003). The next section examines specific regulatory and control failures.

Regulatory/Control Context

The regulatory/control context looks at the social control mechanisms surrounding the cases, including non-governmental and informal control systems, such as industry organizations, stock exchanges, and self-imposed oversight. This section will explore the breakdown of these systems, including 1) lack of regulatory resources and 2) failure of other control mechanisms.

Lack of Regulatory Resources

Regulators have often been marginalized by political constraints that prevented the discovery and sanctioning of corporate fraud. During periods of economic growth, regulators and policymakers face pressures to avoid restricting economic opportunities and corporate profits (Gerding, 2006). This phenomenon occurred in the environment surrounding all four of the scandals, with political pressures marginalizing the ability of regulatory agents to act. Regulations are ineffective if the regulatory agencies charged with enforcing those regulations are stripped of the power to take action and issue proper sanctions. Insull, S&L, and Enron saw resources for regulators eliminated, while the regulatory oversight was absent in the Cooke scandal.

Railroads operated in an entirely free market environment and rose and fell with the conditions of the economy. At the same time, local, state, and federal governments were subsidizing them with public money. The state regulatory agencies overseeing utilities in the Insull case were ineffective at controlling corporations that crossed state lines. The focus on regulation instead of public ownership of utilities allowed private utilities owners like Insull to
manipulate a single regulator instead of having to work with hundreds of municipal governments. State regulators also contributed to the advancement of the utilities industry by negotiating price reductions to attract consumers.

The same problems occurred during the height of the S&L crisis, as political pressure to loosen regulations painted anyone who attempted to restrict the activities of thrifts as being obstructionist and against helping the struggling industry to succeed. As a result of federal deregulation, state regulatory agencies were forced to lower their standards of oversight on thrifts and offer more attractive deals to institutions to dissuade them from leaving the state charter organization. Securities regulation was lacking in the Enron case due to a political climate that limited the ability of the SEC to enforce securities laws effectively (O’Brien, 2005). The failures of these regulatory agencies in the four cases were compounded by the failures of other methods of social control.

*Failures of Other Control Mechanisms*

Other measures of control within industries or organizations were either non-existent or ineffective. Regulatory agencies did not exist in the time of Cooke, leaving the only checks on speculative risk-taking with government money in the scattered hands of three main entities: an uniformed public attempting to settle and establish an infrastructure in the aftermath of the Civil War, a corrupt government structure that encouraged the abuses of emerging financial giants and railroad corporations, and the industry itself that was solely focused on expansion and profit maximization. Until Arthur Anderson was appointed to audit Insull’s accounting records, Insull was able to manipulate self-appointed auditors to give approval of fraudulent accounting records. The FSLIC mitigated the damage from S&L fraud but provided no effective oversight or risk assessment. An anti-regulatory attitude effectively eliminated any social control mechanisms
that may have stopped the industry-wide S&L fraud. In addition to the failure of Enron auditors, the securities analysts charged with overseeing the soundness of these securities worked for investment banks, and issued inaccurate assessments of stock values due to a conflict of interest in the funding for stock research (Aronson, 2002). The three contexts described in this section provide the backdrop for the organizational deviance that occurred in each of the four cases. The next section moves from the general conditions surrounding the cases to the specific deviant actions of those involved in the scandals.

Organizational Deviance

Organizational deviance focuses on the culture and collective harms in the commission of corporate scandal. Constant pressures to achieve profits and meet the projections of both internally and externally imposed goals resulted in risks and speculation. This included manipulation of others through deception, omission, or destruction of evidence to cover up wrongdoing. This section examines two of these common elements, including 1) deception/manipulation, and 2) complicated facts.

Deception/Manipulation

Each of the four cases involved manipulation of securities valuations to make investments seem safe and profitable. The entire Northern Pacific Railroad was a misleading project with management keeping problems concealed from the public and only presenting favorable results, despite the constant funding issues, inadequate construction, and Native American attacks (Lubetkin, 2006). Insull and Enron were perhaps the most blatant examples of stock manipulation, as stock values were deliberately kept artificially high due to complicated and fraudulent accounting practices. Insull’s IUI and Corp holding companies had stock values that were outrageously priced even though the companies held little capital and few assets
outside of one another’s stock. Enron, on the other hand, used SPEs as shell corporations to hide debt and make the company appear profitable when it was actually losing money. Investor overconfidence fed miscalculations of the various risks involved in investing in Enron stock, despite financial inconsistencies (Gerding, 2006). S&Ls became involved in risky markets and covered up signs of insolvency, including manipulating financial records to conceal fraud. While these actions deceived everyday depositors and regulators, the real victims were the taxpayers who were forced to repay insured deposits (Calavita & Pontell, 1990).

**Complicated Facts**

In each of the cases, the complicated nature of the financial system made it more difficult to understand whether what was occurring was ingenious business innovation or outright fraud. These complications offer an explanation as to why the crimes were not detected until after the scandal had come to public light and the damage had already been done. The complexity of the financial structures was so overwhelming that not even those inside the organizations fully understood them. This was certainly true for Cooke, Insull, and Enron, where the iconic status of each entity allowed them to raise capital without having to give more simplified explanations of their financial structures.

Those investing in Northern Pacific were unaware of the complicated financial structure and believed their investments were safe by being placed in the expanding railroads. In the Insull and Enron cases, enough public information was available for a rational investor to sense something suspicious about the securities, but few were able dissociate themselves enough to do so (Cudahy & Henderson, 2005). The Insull financial holding company structure was so complicated that even Samuel Insull himself did not entirely understand how it worked. The S&L industry was insured by the federal government and used this fact in their sales pitch to
assure investors. Enron executives knew that as long as new projects were created to show
profits on balance sheets, numbers would appear favorable and investors would trust their money
with the company.

The management of these companies was free from having to offer explanations that
would have exposed the criminogenic nature of the organizations. Most investors were
interested in following the stock bubble toward ever increasing wealth. By the time the bubble
burst on these scandals, some had gotten rich while most investors had lost everything. They
were left with feelings of betrayal, confusion, and anger. These cases saw continuous growth
caused by fraudulent methods of making the financial system appear complicated to the point
that it was difficult to impossible for anyone to clearly understand. Each of these cases had
complicated financial structures built on unstable foundations.

The criminological contexts and organizational deviance discussed here provide the
background for explaining some of the common factors in the four cases. These scandals could
not have occurred without speculative investments, focuses achieving Wall Street profits
maximization, and corrupt political involvement with business. The next section will illustrate
the initial societal responses to the discovery of the organizational deviance.

Scandal

The scandal is the revelation of the severe consequences to the public. Backlash toward
the corporation is an essential element of the scandal, without which effective mobilization of
social control and reform would be improbable (Sherman, 1978). This section will look at the
immediate environment surrounding each of the scandals, including 1) collapse/insolvency/
bankruptcy and 2) severe economic/social costs.
Collapse/Insolvency/Bankruptcy

Each of the cases involved rapid decreases in the values of investments that led to eventual collapse, insolvency, or bankruptcy. As the economy worsened, Cooke securities sales for Northern Pacific slowed and investors unloaded their stock. Public confidence in the Northern Pacific eroded after news reports claimed the project was pure speculation and the financial structure supporting it was unsustainable (Skeel, 2005). Coupled with stories of fraud, political corruption, lavish lifestyles, and misuse of taxpayer subsidies, Cooke & Co. was unable to raise enough capital to pay creditors (Lubetkin, 2006; Kens, 2009). The Cooke collapse brought about Wall Street panic, as chaos and anger filled the streets. A similar realization occurred in the Insull scandal when New York bankers took over IUI and Corp, giving them access to Insull’s accounting records (Cudahy & Henderson, 2005). Middle West was found to be completely insolvent, not having made real profits in years. IUI and Corp were also worthless stocks (‘Says Insull,’ 1934). Insull was forced to resign from his many directorships and president positions as the stock value of the securities fell to junk status.

The S&L industry lost $7.5 billion in the first half of 1988 as organizations became insolvent while executives and employees of thrifts made millions in personal profits (Calavita & Pontell, 1990). Enron followed this same pattern of decline, as the news of Skilling’s resignation as CEO and the restatement of earnings led to stockholders selling off Enron stock at a rapid pace. At the same time, Enron executives cashed in their stock options and made millions of dollars while employees of Enron-owned businesses were locked out of their accounts (McLean & Elkind, 2003).
Severe Economic/Social Costs

Each of the four scandals brought severe economic and social costs with negative implications for ordinary middle and lower class Americans. Cooke’s failure set off a chain reaction of bank, railroad, and business failures between 1873 and 1875, as many middle and lower class farmers, merchants, and retirees suffered the consequences. The same occurred in the Insull collapse, as the majority of shareholders were middle and lower class Americans. The total losses to thrifts resulting from failed assets were $519 billion from 1986 to 1995, with the federal government paying $123.8 billion (Curry & Shibut, 2000). When Enron was finally forced into bankruptcy, tens of thousands of employees and investors had lost their jobs and savings. The majority of those who suffered from these scandals were stockholders, creditors, and taxpayers. The social costs, such as loss of confidence and psychological distress, do not account for the cost of law enforcement, legislative, and correctional efforts, making these crimes even more costly than if only economic harm is considered (Zimring & Hawkins, 1993).

The preceding sections have largely focused on the contributing factors and the costs of the four scandals. These have provided the foundation for the examination of the societal responses to those scandals, which will now be the focus of the analysis. This section will be divided into two parts: 1) social control, and 2) reforms.

Social Control

Social control mechanisms employed in the wake of the four scandals address the problems through the use of existing statutes or control systems within an industry or organization. This section will illustrate these social controls and analyze similarities and differences between the various responses. The common factor found in social control mechanisms employed in the wake of a scandal was the misplaced focus on individual sanctions.
**Misplaced Focus on Individual Sanctions**

The problem of social control responses has been the failure to address the problems from a prevention standpoint. Rather, the response represents a back-end deterrence approach that assumes white-collar crime can be reduced by issuing large penalties. By only directing resources at individual offenders, the structural system and organizational culture that created the scandal go unaddressed.

The Cooke and Insull cases saw some level of social control being evoked that handled the immediate circumstances of the scandal but failed to achieve individual justice. Cooke was effectively targeted as the perpetrator of the scandal and was prevented from participating in any banking ventures for the rest of his life (Lubetkin, 2006). Although others within the Northern Pacific and Cooke & Co. had participated in fraud, corruption, and risky speculation, no one involved with the scandal was subject to criminal proceedings. At the time, the Cooke collapse was viewed as an unfortunate business failure brought on by bad decision making that was perhaps unethical but not criminal. The Insull scandal, on the other hand, saw a significant use of social control being evoked to hold the perpetrators of the fraud accountable. Many within the Insull-led companies, including Samuel and his brother Martin, were indicted on charges of embezzlement, larceny, and mail fraud (“Insull Downfall,” 1934). Insull and sixteen co-defendants were put on trial but were acquitted of all charges (“Insull Acquitted,” 1934).

Social control mechanisms have been effective in some cases, including the prosecution and conviction of many white-collar criminals in the wake of the S&L and Enron scandals. Federal regulators failed to handle the fraud that took place in the industry prior to 1989, as most offenders were not discovered and those who were received lenient sentences (Calavita & Pontell, 1990). Once the scandal came to fruition, the criminal law was applied to industry
offenders for individual white-collar crimes. The FBI budgeted more than $125 million to pursue cases of fraud in 1991 alone, resulting in more than eight hundred convictions with three-fourths of those being sentenced to prison (Glasberg & Skidmore, 1998). This same logic applies to the Enron and Insull scandals, where individual offenders were pursued for their culpability related to the scandals. Many Enron executives pled guilty to or were convicted of felonies related to the fraud, conspiracy, money laundering, and insider trading. The response to the Enron scandal took several years, but rested highly on punitive sentences against executives who were found to have violated securities laws.

Perhaps the biggest social control response was the increased attention brought to the problem of corporate fraud and the enhancement of enforcement efforts to address individual criminals. Individual sanctions for corporate criminals define the issue as a justice system problem. Prosecuting white-collar offenders holds those who are responsible accountable for their actions, and sanctions them accordingly. The increase in resources also gives assurance to the public that something is being done about the problem. However, many of these resources may be misdirected and only address a small portion of the actual problem. In addition to targeting individual offenders, scandals are often addressed through various reforms. These reforms will be the focus of the remainder of this chapter.

Reform

This section will focus on the effectiveness of the reforms, including identifying shortcomings and loopholes in the policies. This will allow an investigation of the successes and failures of these efforts. The common elements found among reforms include: 1) symbolic reforms, 2) failure to account for conflicts of interest / political constraints on regulators, and 3) strengthening of failed institutional power structure.
Symbolic Reforms

The reforms in the four cases were symbolic legislative creations that addressed past crime problems but ignored structural issues. They “appear to have been taken off the shelf and put into the mix, not so much because they would have helped to prevent the scandals, but because they filled the perceived need for far-reaching reform and were less controversial than other measures more clearly aimed at preventing similar scandals” (Chandler & Strine, 2002, p. 6). The corporate structure and the operations of the securities market created opportunities for crime. The crimes have become more sophisticated and complicated over time, making them harder to detect, punish, and prevent. The cumulative reforms represent a Maginot Line of defense against corporate fraud, each looking backward at the previous scandals and ignoring what might occur in the future. As impressive and imposing as this Maginot Line of regulation may be, it is an ineffectual means of protection against future corporate scandals.

Reforms in the Cooke case did not occur immediately on the federal level and were first limited to individual states. When the Interstate Commerce Act passed more than a decade after the Cooke failure, it was the first extensive regulatory effort to provide oversight of the railroads (Skeel, 2005). The reform limited the most egregious actions of the railroad companies, including discriminatory rate setting based on geographic area and special rebates to some shippers and not others. However, the Interstate Commerce Act had been watered down after extensive lobbying efforts and campaign contributions on behalf of railroad companies to members of the legislatures, making it less effective (Kirkland, 1961).

New federal securities violations created by the Securities Act of 1933 and the Securities Exchange Act of 1934 established a structure of oversight on the securities market. The central concept behind the securities laws was that the public would be able to protect itself from
speculative securities if issuers were required to disclose complete and accurate financial
information (Cudahy & Henderson, 2005). These laws addressed one of the problems of
investor disadvantage in securities that was evident before Insull when few financial disclosure
requirements existed (Wasik, 2006). However, these laws needed to be updated and
strengthened over time to continue to be effective. Companies and financial structures became
increasingly complicated over time and the SEC was progressively more inadequate at providing
oversight.

FIERRA is perhaps the most obvious case of symbolic reform in the S&L industry,
where no real reform was implemented. This legislation aimed to clean up after thrift failures by
helping mitigate the damages of insolvent S&Ls but failed to recognize the problems born out of
1980s deregulation. Instead of addressing previous deregulatory legislation, FIERRA was
isolated to S&L industry alone. The federal government put itself in a position where the law
guaranteed that individual depositors would not suffer, thus opening the system for future fraud.
This failed to address many of the underlying causes that created both the incentives and
opportunities for industry-wide fraud (Calavita & Pontell, 1990). The laissez-faire attitude that
began in the 80s continued after this legislation with more deregulatory acts passed in the 90s.
The failure to learn the lessons of the S&L crisis manifested nearly twenty years later when a
similar epidemic of fraud occurred in the mortgage industry requiring yet another influx of
taxpayer money to stabilize the financial system.

The Sarbanes-Oxley Act passed in the aftermath of Enron was touted as addressing
fundamental problems in corporate governance. However, these reforms addressed some of the
problems that led to the Enron scandal while leaving others virtually untouched. The benefits of
these provisions are the provisions increasing shareholder independence and restrictions on the
revolving door between companies and their auditors. The inclusion of an independent board of directors and CEO accountability made it harder for CEOs to conceal fraudulent activities and allowed shareholders to become more involved in choosing directors (Stelzer, 2004). However, the problems of investor disadvantage in relation to securities analysts and rating agency failures was not addressed adequately, nor were the incentives provided by stock options to inflate the value of stocks for profits.

The reforms merely served to quell the fears of investors, giving the impression that Congress was addressing the problems. Once reforms moved through the legislative process, they were often reduced to mere shells of the original intention after numerous negotiations and compromises to appease special interests. This is certainly true for the current financial regulatory reforms of 2010, as loopholes are likely to be found and the strength of the reforms undercut over time. A truly efficient and effective reform will be one that takes the cyclical nature of scandal and reform into account by placing safeguards into the legislation that make it more difficult to reduce its effectiveness.

Failure to Account for Conflicts of Interest/Political Constraints on Regulators

Reform efforts failed to account for conflicts of interest found in corporate oversight mechanisms and ignored political constraints on regulatory agencies that neutralize new regulations from being effective. The focus on controlling conflicts of interest would become a key feature of successful reforms and the major downfall of others. The collapse of Cooke & Co. led to the rise of J.P. Morgan as the main financier of the banking industry. The banking conglomerate led by Morgan would later be replaced by the Federal Reserve Board, which would remain a private entity in close association with large banks (Johnson & Kwak, 2010).
This interconnection between regulators and the industries they are supposed to regulate is a key feature the political limitations placed on regulators.

The New Deal reforms implemented after Insull represent a break from this pattern as a financial infrastructure was established that did address many of these conflicts of interest. One successful piece of legislation was the Glass-Steagall Act that recognized the inherent flaws with allowing commercial banks that take individual deposits and provide loans from concurrently acting as investment banks that took risks with industries and innovative projects. The Public Utility Holding Company Act of 1935 was also successful at breaking up the powerful holding company structure into many smaller, more manageable utilities companies that could be regulated by the states (Cudahy & Henderson, 2005). The large holding company structure was considered a straw house that could not be sustained in times of economic downturn and encouraged harmful speculative behavior (Wasik, 2006). This act along with the creation of the Federal Power Commission by the Federal Power Act of 1935 successfully stabilized the energy distribution system for several decades, even though the laws would later be altered or eliminated by deregulation that contributed to the Enron scandal (MacAvoy, 2000).

The restrictions on commercial and investment banking would also be weakened over time and eventually repealed in 1999, opening the door to new levels of risk taking and allowing large banks to become even more powerful through the trading of mortgage-backed securities (Johnson & Kwak, 2010). The major weakness of many of the Insull reforms was that the same methods used to eliminate complicated, monopolistic utilities organizations were not applied to all forms of business. While representing a significant positive step forward in securities laws, many systemic issues related to corporate crime went untouched and resulted in the regulation structure being slowly broken down over time.
The S&L reform created the RTC, but this dealt with the symptoms of the problem instead of the failures of regulators and the legislature. An industry-only approach to handing the S&L case ignored the conflicts of interest inherent in the relationships between thrifts and regulators and the political forces that prevented overwhelmed regulators from providing oversight. Once the political tide again turned toward a hands-off philosophy and the RTC was abolished, the lessons of the S&L crisis were quickly forgotten.

Although the Sarbanes-Oxley Act strengthened restrictions on non-auditor services that could be performed for companies by auditors, this only addressed one component of the disadvantage investors face over industry insiders (O’Brien, 2005). Corporations are still able to choose their own auditors, favoring those that might be willing to overlook potential problems (Skeel, 2005). The conflict of interest with securities analysts goes almost completely untouched under Sarbanes-Oxley. Until the sub-prime mortgage crisis 2007-09, few cases had been filed against securities analysts for fraud (King, Corrigan, & Dukin, 2009). Sarbanes-Oxley did nothing to address the complicated relationships corporations have with investment bankers, who provide research analysis for companies. Issues of conflicts of interest remained and corporate scandals have continued to cause immeasurable levels of harms to society, which speaks greatly to inadequacy of the Sarbanes-Oxley reforms (Coffee, 2003). Regulations are ineffective if those enforcing them are closely allied with the industry and are more concerned with promotion than restraint. As these corporate scandals have unfolded, reforms have continued to rely on the same methods tried in the past by simply giving more powers to regulatory agencies that have been proven unsuccessful at preventing the crises.
Strengthening of Failed Institutional Power Structure

The major failure found consistently throughout all four corporate crime scandals is the strengthening of the same failed institutional power arrangements that caused them. Reform policies have made these large corporations and Wall Street banks even more powerful by declaring them too interconnected to fail. The system of protection set up under the Federal Reserve Board created a government insurance program that represented a ‘moral hazard,’ in that banks were given the incentive to take on more risk to benefit shareholders at the expense of taxpayers and the stability of the financial system (Johnson & Kwak, 2010). This is a key component to the concentration of power in large financial institutions and corporations at the national level.

The Cooke case saw the same power structure of finance remain in place that had previously existed, as there was no public entity with the power to stabilize the financial system in the event of a crisis. The power of the large banks that had not failed was greater than before, as smaller institutions were unable to withstand the pressures of the unstable economy. The troubles in the S&L industry culminated as a result of the shifting focus of power toward large investment banks and away from smaller, local thrifts that collapsed under the weight of the national financial system. The reforms did nothing to address this problem related to the concentration of corporate power. The Enron-related reforms also did nothing to address the 1990s power acquisitions and mergers by large institutions. Rather, companies were required to hold themselves accountable through the certification of financial statements. Nothing inherently changed about the corporate structure or the way CEOs conducted themselves. Internal compliance systems such as the ones required in the Sarbanes-Oxley Act do not ensure
that a corporate culture will be changed to better reflect the desires of investors and offer more accurate internal financial information (Skeel, 2005).

Again, the exception to this cycle was evident in the Insull case as the severity of the Great Depression gave reformers the political power necessary to pass sweeping and successful financial reforms targeting the potential threats posed by large institutions. The fact that the Federal Reserve was unable or perhaps unwilling to stop the largest financial crisis in the history of the US at the end of the 1920s signifies the failure of that system. The Glass-Steagall Act was a successful reform that increased the powers of presidential appointees to make decisions in the Federal Reserve while concurrently weakening the power of banks (Johnson & Kwak, 2010). It also allowed the SEC to regulate investment banks to a greater degree, focusing on disclosure and fraud prevention. The result was the safest and most balanced financial system in the history of the United States. This focus on keeping powerful institutions in check represents a break from traditional political history that has allowed large companies to constantly gain more power. Although the Glass-Steagall Act worked to correct the power domination of large institutions over the Federal Reserve, the fundamental structure of the Fed has remained in place and is strengthened by each subsequent reform. The successes of the reform laws after Insull have faded into a distant memory as the largest corporations and banks are arguably more powerful than at any particular point in time.

Major financial institutions have increased rapidly in size from less than twenty percent of the total gross domestic product (GDP) in 1995 to over sixty percent of the GDP by 2009 (Johnson & Kwak, 2010). These institutions have become increasingly large, to the point where their potential failure threatened the entire American economy. This focus on centralized institutions works against competition and the health of the free market economy as smaller
banks and businesses are unable to compete. By continuing to provide monetary assistance to large corporations in the form of bailouts and subsidies, the government increases corporate power over the economy and decreases the legitimacy of possible control mechanisms. Corporations have no incentive to act with restraint or behave in an ethical manner if they know their harmful risk-taking will be cleaned up by the government with no real cost to themselves or their organizations. Reform efforts have continued to consolidate power in these large institutions and ineffective the governmental agencies (Douthat, 2010).

This section illustrated the fundamental weakness that has resulted from the cycle of scandal and reform. A major shift away from the centralized elite power domination is necessary to prevent the next state and corporate crime scandal from being even more damaging than those that preceded it. These four cases each had reforms that were meant to act as solutions to what was perceived as the major causes of the scandals. This failure of reform has ignored key elements of financial scandals that have contributed to the repeating patterns over time.

Conclusion

This chapter examined societal responses to the four cases of financial and corporate crime by systematically applying a framework using cross case synthesis in search of common patterns. This analytical approach was shown to be successful at integrating the various aspects of the cases together. The use of the scandal and reform model as adapted from Sherman (1978) revealed a cycle of scandal and reform in American securities laws and highlighted the strengths and weaknesses of various reform efforts. Chapter VI will discuss various policy alternatives.
CHAPTER VI.
DISCUSSION AND POLICY ALTERNATIVES

The analysis conducted in Chapter V identified consistent patterns of scandal and reform among corporate scandals. It is important to recognize important policy alternatives in order to take the necessary measures toward the prevention of future crises. This chapter will attempt to make sense of these alternatives. First, it is essential to acknowledge several limitations of the analytical strategy. Second, four areas of policy alternatives discovered in the analysis will be discussed. These include: 1) reform and regulatory/control context, 2) social control, 3) societal and political contexts, and 4) organizational deviance.

Limitation of Analytical Strategy

After applying the model in Figure 1 to the four cases in Chapter V, it was determined that the research strategy was flawed in some respects. Sherman’s (1978) conceptualization dealt with public entities, whereas this thesis focuses on private companies. The fundamentally different natures of these entities render the application of some aspects of the Sherman’s original idea ineffective. Sherman (1978) focused on reforms within public police organizations that produced a positive change, primarily due to the ability of the police departments to reform their own actions from within. This thesis instead points out a scandal and reform cycle where the reform efforts were unable to fix the problems. The limited application of this concept was noted in Chapter III, which is why a loose adaptation of the model was used in Chapter V.

One of the biggest challenges with the analytical strategy was the synthesis of distinctly different cases. When applied to the model, some cases revealed contradictory results. Not all of the parts of each case could be applied, as several of the cases were revealed to be fundamentally different. Despite these weaknesses, the main goal of this thesis to uncover a
cycle of scandal and reform was met. The analysis in Chapter V was able to show several common patterns among the cases over time, uncovering several failures that have consistently weakened attempts to control corporate crime. A similar model could be used to analyze other cases of corporate crime with perhaps a single case focus instead of multiple cases. A common model for analyzing the failure of reform efforts over time is still lacking in criminological research. This thesis provides a foundation upon which further research can build. The remainder of this chapter will focus on discussing various policy alternatives.

Reform and Regulatory/Control Context

The common failure found in the reforms was the reliance on regulators. Regulatory agencies are ineffective due to the ‘Revolving Door’ (Simpson, 2002). Regulators are taken from the very industry they are charged with regulating, creating an inherent conflict of interest. The main idea proposes those inside an industry are the most capable regulators because of their intimate knowledge of the inner workings of the system. This give and take relationship between regulators and industries has made the systems increasingly complex. Many ordinary persons are incapable of understanding these complications, which further strengthens the argument that insiders should be placed in regulatory roles.

As was discussed by Simpson (2002), the SEC regulators were found to fit this pattern. The SEC proved to be an inadequate enforcement agency as it failed to uncover abuses both prior to and after the passage of the Sarbanes-Oxley Act (King et al., 2009). Part of the problem can be attributed to the inadequate enforcement budget given to the SEC and other regulators by political leaders (Skeel, 2005). However, the more pressing issue is the ideological conviction of regulators that self-regulation is more effective than a hands on approach. The new proposed consumer protection agency is the current proposition to partially accomplish this by protecting
consumers against risky loan and credit cards (Nocera, 2010). However, the inclusion of the agency as part of the Federal Reserve and not as an independent agency minimizes its strength, consistent with the symbolic reforms discovered in the past scandals. Many large banking institutions have begun to support the new consumer agency and show little concern over its passage (Frates, 2010). This illustrates the inadequacy of the proposed agency. The failure to recognize conflicts of interest and the revolving door thesis is likely to be a contributing factor to future scandals if not addressed.

There have been several ideas proposed in response to regulator conflict of interest. One alternative strategy is to require the assignment of independent auditors and analysts to companies. Auditors and analysts would be assigned to corporations instead of allowing the companies to choose their own oversight entity. This idea was proposed during recent financial regulation discussions to address credit rating agencies whose positive ratings on sub-prime mortgage-backed securities contributed to the financial crisis of 2008. The proposal was to create new conflict-of-interest rules for ratings companies by requiring the random assignment of ratings agencies, but the provision was dropped during final congressional negotiations (Herszenhorn, 2010).

Another alternative to address the ‘Revolving Door’ is to promote individuals from outside an industry to regulatory agencies. CFOs and CEOs could be required to report to outside regulators in non-technical language. This response would eliminate the perceived need to have industry insiders with an intimate knowledge of the complications of the industry. This was a response to the BP oil crisis, as the Minerals Management Service (MMS) had followed the pattern of insiders heading oversight. The agency was broken into several pieces and new leadership from outside the industry was appointed to restructure oversight of the oil and gas
industry (Soraghan, 2010). This could be a step in the right direction for reform, but the culture of relationships between industry and regulators should be given greater attention.

While many ideas have been discussed, the failures of regulations continue to occur. Political constraints continue to be a major weakness of reform efforts. The effectiveness of regulation depends greatly on the political will of government leaders to appoint effective external regulators. This problem has not been addressed and is unlikely to be solved without a reconsideration of the fundamental role of regulatory agencies in business oversight.

Social Control

Typical corporate crime responses consist of one of two options: 1) prosecution of individual offenders, or 2) the imposition of monetary fines on the corporation. Both of these approaches appear to have some merit. The argument for individual prosecution is that focusing on individual offenders holds these persons responsible for their decisions, thus increasing individual deterrence against white-collar crimes (Geis & DiMento, 1995). However, this implies that issuing criminal sanctions will be possible. In the Cooke and Insull cases, offenders were able to avoid criminal sanctions. Cases often take long periods of time to get to court, undermining the deterrent effect of punitive sanctions. Furthermore, research has questioned the deterrent effect of the threat of external sanctions on corporate offenders (Makkai & Braithwaite, 1994). This individualistic focus also implies that individual offenders can be discovered, which is difficult in complex corporations. There are exceptions to this, notably in Enron and WorldCom where top executives were prosecuted. Even though many offenders were prosecuted and issued sanctions in the Enron and S&L cases, larger organizational forces were left unaddressed (Giroux, 2008).
Applying sanctions only to individual corporate offenders ignores the organizational deviance responsible for facilitating corporate crimes. The focus on individual offenders relieves the corporation from responsibility for its crimes. The second option is to hold the corporate entity responsible. The typical means used is the issuance of fines. Research has discovered this to be the most typical form of organizational sanction, although it has been found to be mostly ineffective (Mokhiber, 1988). Fines would need to be unrealistically large in order to achieve a deterrent effect that would overcome potential profits and the unlikely probability of detection (Coffee, 1981).

Other propositions for how corporations can be held accountable for their crimes deserve exploration. These revolve around the use of comparable sanctions against corporations, just as individual offenders are sanctioned (Walt & Laufer, 1992). Instead of issuing fines or imposing lengthy sentences on individuals, probation and rehabilitation should be explored as punishment options. Probation would require increased scrutiny and observation of corporate activities to ensure compliance with laws and to mitigate harm (Walt & Laufer, 1992). Rehabilitation could focus on ordering certain conditions of compliance upon a corporation. These conditions could involve the publicly ordered restructuring of the organization to eliminate an unethical corporate culture. A certain component of a corporation identified as a chronic offender could also be severed from the organization and sold, with the judge determining the distribution of the proceeds (Walt & Laufer, 1992).

Corporations could also be required to contribute all fraudulently obtained money into a fund to that is redistributed to those who have been harmed (King et al., 2009). This approach is currently being used with the BP oil spill, as the company has been required to establish a $20 billion fund to compensate for losses to local businesses (BP, 2010). Another rehabilitative
option is to require companies to publicly acknowledge their offenses and admit guilt in a media campaign designed to deter others from similar conduct.

The major downfall of focusing on corporations is the time and effort necessary in investigating these complex entities. Focusing on corporations can also have a negative impact on innocent parties, including shareholders, consumers, and employees (Geis & DiMento, 1995; “Can the,” 2010). Political constraints of externally imposed conditions also limit the success of these alternative sanctions. Despite these limitations, various organizational sanctions should be explored as a means of social control for corporate crime.

Societal and Political Contexts

The societal and political contexts revealed a nexus between state and corporate influences. Each time a crisis of this magnitude occurs, those who are responsible for creating it are called upon to fix the problem (Douthat, 2010). This strengthens these entities, giving more power to the same regulators who proved ineffective at preventing the crisis. As was previously established, the argument for industry insiders as regulators was that the system had become so overly complex, only those within the industry had enough expertise to address the problem. As these institutional arrangements between business and politicians became more powerful, each cycle of reforms has made the system even more complex and centralized. These changes ultimately make the system vulnerable to the next major crisis due to the unwillingness to address this cycle (Douthat, 2010).

This problem lacks clear and easy solutions. Relationships between government and private entities are well established and elites seem content with maintaining the status quo. The most effective solution may rest in simply raising public awareness. The public needs to recognize two essential elements of these relationships: 1) these relationships do exist, and 2)
they can produce large-scale social harm. After Enron, there was a widespread realization that problems within corporations were not limited to just a few organizations (McBarnet, 2006). However, public anger was largely directed toward corporate offenders instead of government entities. The TARP program has increased public awareness of the relationships between policymakers and corporations, as widespread anger has been directed toward this “bailout” of the banking industry (“Credit Crisis,” 2009). There have been calls for reform and change, but these have consistently been shown to be symbolic. Fundamental flaws in the system are rarely addressed and were only touched on in one of the cases analyzed in Chapter V. The financial regulatory reform bills passed by Congress are also likely to contain loopholes and be watered down over time. Politicians should not be relied upon to address the problems they helped to create. It is the responsibility of the public to demand accountability for government and corporate actors by becoming more aware of the true nature of how the financial system operates.

Organizational Deviance

The actions of individual offenders often are shaped by corporate policies and culture that promote and encourage unlawful behavior. One of biggest questions raised as a result of this thesis involves the best way to fix greedy corporations. This thesis illustrates the failure of externally imposed reforms to fix corporate crime problems. This is partially due to state influences that undermine reforms. External reforms also fail because of the tendency of organizations to resort back to old patterns of behavior after the publicity surrounding the scandal is quelled. Sherman (1978) discovered this in his examination of corrupt police organizations. His analysis found the most effective solution to organizational deviance was for the organization itself to impose internal reform changes. Organizations holding themselves
accountable for ethical behavior are an essential element in positive changes that reduced corruption over the long term (Sherman, 1978). This same philosophy could be applied to corporations. While external oversight and guidelines are important, corporations are ultimately responsible for ensuring they are behaving ethically.

Insisting on organizations to fix themselves is not a simple task and should not be taken lightly. The failures of self-regulation evident in the analysis of this thesis illustrate the dangers of a hands-off approach to enforcing corporate crime. Creative methods of fixing ethics problems should be discovered, implemented, and evaluated. One such strategy involves the use of education. Efforts to raise ethics standards in the business culture instituted after Enron are worth noting as a possible means to this end. Enron brought an increased focus on business ethics in MBA schools (McBarnet, 2006). Prior to Enron, little emphasis was placed on business ethics in MBAs, as graduates were more concerned with increasing share prices (Gray & Clark, 2002). The idea behind this approach is to teach proper business ethics before students enter their careers with the hope that better education will make them more aware of the damages caused by reckless, profit-focused decisions. Research into these programs needs to be conducted to determine their effectiveness, but the alternative is worth pursuing.

Another option is to encourage business compliance through incentives for ethical behavior. The US Sentencing Commission’s (2004) guidelines outlined the requirements for companies to develop codes of ethics, including the encouragement of an ethical organizational culture, training, and discipline procedures. It is difficult to assess whether these requirements were taken seriously or if symbolic compliance has been made (McBarnet, 2006). More research is needed into these types of interventions, including policy evaluations aimed at the effectiveness and efficiency of corporate ethics policies.
Conclusion

This thesis has discovered several general themes common to four cases of corporate scandal throughout American history. Further research into corporate crime is necessary to improve the understanding of the nature of this issue. There has been a lack of funding for corporate crime research compared to crimes committed by the powerless and relatively few recent scholars have been produced in this field (Snider, 2003). This trend should be reserved with increased scholarly attention to corporate crime. Researchers should utilize the case study approach as well as quantitative and qualitative methods. Corporate crime scholars should give particular consideration to the ‘Revolving Door’ and the failure of reforms. This will continue to prove difficult, as corporations and government agencies tend to restrict access to information from researchers (Berrington, Jemphrey, & Scraton, 2003). Skilled researchers should develop new and creative ways to examine corporate cultures, regulatory systems, and the connections between them. This effort would continue to increase the knowledge base surrounding corporate and financial crimes in search of possible solutions to these complicated problems.
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Legal Citations


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