

ENCYCLOPEDIA OF  
WHITE-COLLAR &  
CORPORATE CRIME

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CORPORATE CRIME  
Volume 1

GENERAL EDITOR  
LAWRENCE M. SALINGER, PH.D.  
ARKANSAS STATE UNIVERSITY

A SAGE Reference Publication

 **SAGE Publications**  
Thousand Oaks ■ London ■ New Delhi

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Volume 2

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ENCYCLOPEDIA OF

# WHITE-COLLAR & CORPORATE CRIME

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## CONTENTS

### VOLUME I

Introduction	vii
Reader's Guide	xi
Timeline	xvii
List of Contributors	xxiii
List of Articles	xxv
Articles A - I	1

### VOLUME II

Articles J - Z	455
Appendix A: Resource Guide	873
Appendix B: Glossary	877
Appendix C: Law Summaries	885
Index	929
Photo Credits	974



ENCYCLOPEDIA OF

# WHITE-COLLAR & CORPORATE CRIME

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# Introduction

IN THE 2000s, white-collar crime has become a topic of almost daily news. The white-collar crime that caused the bankruptcy of Enron Corporation resulted in financial losses exceeding \$66 billion to stockholders, and likely helped lead to the recall of the governor of California. Massive violations of laws pertaining to improper investments in mutual funds and large banking firms in the United States have resulted in major losses to legitimate investors, whose losses are still being calculated. The use of shareholders' assets to fund the lavish private lifestyles of corporate chief executive officers, presidents, and chairs of the board of large corporations are becoming the fodder of scandal and media.

For example, television viewers were treated to an edited version of a videotape of Tyco International Limited head Dennis Kozlowski and friends in a \$2-million bacchanal celebrating his wife's birthday at the expense of the corporation. The WorldCom bankruptcy that resulted from white-collar crime caused billions of dollars in lost investments. The costs to ordinary stockholders are massive, but costs to employees, collateral business, communities, and society are incalculable.

Human lives have been altered forever by the unlawful actions of a few whose need for power and profit resulted in illegal, unethical, and immoral acts. While one can conceive of the plausibility that

the offenders did not define their behaviors as criminal, that in part could be because there is no clear definition of what is meant by the term *white-collar crime*.

The concept of white-collar crime was first conceived by Edward Alsworth Ross (1907), and approximately 30 years later white-collar crime was born in the ideas of Edwin H. Sutherland (1939–40). Sutherland, in coining the term, defined white-collar crime as "... a crime committed by a person of respectability and high social status in the course of his occupation." For Sutherland, the white-collar category included "business managers and executives," although, in research, he included corporations as offenders as well. He believed that a white-collar offense was a crime if it proved to be socially injurious and punishable.

Therefore, an act of white-collar crime could be dealt with in a criminal, civil, or administrative manner. Paul Tappan (1947), a lawyer and sociologist, disagreed with Sutherland's argument. Tappan believed that a behavior could only be considered a white-collar crime if the act was legally defined as a crime and if the offender had been convicted for the offense. That is, he rejected Sutherland's belief that a white-collar crime could be a violation of civil or administrative law without being condemned by criminal law. Frank Hartung (1950) argued that while legal definitions were important in

the general scheme of things, white-collar crimes represented a special case. Whereas, in most instances, it is possible to distinguish between criminal and civil violations, in the case of white-collar crime the artificial distinction between civil and criminal laws was blurred and lacked importance. In response to Hartung's statement, Ernest Burgess (1950) rejected a totally legal definition of crime, arguing for a labeling-perspective definition that required that persons could only be criminals if they perceived of themselves as such. From the white-collar offender's perspective, Gilbert Geis's (1967) findings would support Burgess's definition of crime. Geis found that white-collar criminals often do not perceive their acts as crime, and therefore do not perceive of themselves as criminals.

Marshall Clinard and Richard Quinney (1973) replaced the term *white-collar crime* with two other classification categories, Corporate Crime and Occupational Crime. Corporate Crime referred to the criminal behaviors of corporate entities, while Occupational Crime referred to the criminal behaviors of persons within their occupational status.

Laura Schrage and James Short (1978) proposed the term *organizational crime*. They considered such crime in the context of the operative goals of the organization, the actual unstated goals of the organization, which often differ from its official goals. Clinard and Peter Yeager (1980) defined corporate crime as "... any act committed by corporations that is punishable by the state, regardless of whether it is punished under administrative, civil, or criminal law."

Albert Biderman and Albert Reiss (1980) withdrew the idea of status from the definition of white-collar crime. They argued that individuals, other than those of an upper-class, were capable of committing crimes in their occupational roles. As a result, they emphasized the importance of defining white-collar crime as a violation of a position of trust. For example, if a waitress inflates a customer's bill, the customer is likely to pay both the inflated amount as well as a larger tip without realizing that she has been victimized. The waitress, for her part, not only profits personally, but also violates the trust placed in her by her employer.

James Coleman (1989) suggested that many of the attempts to redefine white-collar crime in other terms have undermined Sutherland's 1949 position since they "do not include many of the offenses covered in Sutherland's original definition," and/or

"are best seen as varieties of white-collar crime." Clinard (1990) suggested replacing white-collar crime with the terms *corporate corruption* and *abuse of corporate power*. These terms included both corporate and occupational crimes, regardless of whether they violate criminal, civil, or administrative laws. In addition, Clinard included behaviors that may not be explicitly defined as violations of law, but that may be unethical and/or immoral in the corporate or occupational context. For example, a scientist who cheats on her research by altering the findings of a study may not have violated a law or regulation, but instead has violated an ethical rule or norm of the scientific community. Under Clinard's hypothesis, that person may have committed a white-collar offense, since she engaged in an unethical and/or immoral behavior in her occupational context.

For the purposes of this encyclopedia, white-collar crime can be defined as:

Any behavior that occurs in a corporate and/or individual occupational context; and, that is committed for personal and/or corporate gain; and/or, violates the trust associated with that individual's and/or corporation's position and/or status; and that is a violation of any criminal law, civil law, administrative law, rule, ruling, norm, or regulation condemning the behavior.

This definition is necessarily both sociological and legalistic in nature, and therefore includes any behavior that may be socially defined as unethical or immoral, as well as behavior that is not legally defined as an offense. In addition, the definition does not include Sutherland's requisite that the violation be "committed by a person of respectability and high social status." This description was not included because white-collar crimes can be committed by persons who do not necessarily hold "high social status."

Bank tellers do not usually enjoy high social status in our society however, they are in a position of trust where they can engage in white-collar crime. Furthermore, John Hagan and Patricia Parker (1985) have suggested that those persons convicted for white-collar offenses are more likely to be in middle-management than in the high prestige and social status group of the top managers in criminal corporations. Finally, punishability for an act is not an important issue. However, it may be assumed that if an

act is a violation of some law, then it must be punishable as well. This broad definition of white-collar crime may bother some scholars in the field. However, given the diversity of the behaviors that have come to be described as white-collar and corporate crime, it is difficult to create a succinct definition without necessarily excluding some of the tangential behaviors.

## HISTORY OF WHITE-COLLAR CRIME

Laws against those actions that have come to be defined as white-collar crimes have existed since ancient times. Usually, such laws were developed in reaction to events in which there was a perception that something had occurred that challenged the moral sensibilities of the society. Geis, in his article in this encyclopedia on ancient mercantile crime, discusses the creation of laws to protect consumers and to guarantee an adequate food supply for the people. While hoarding grain in order to reduce supply and provide large profits might make sense to a lot of people, hoarding could also lead to public unrest and the overthrow of governments that chose to do nothing to guarantee a reasonably priced supply of staple foods.

George Robb (1993) described the cyclical development and repeal of white-collar crime laws in response to specific acts of fraud and immorality in business that brought fortunes to some and ruin to many. Many of these laws were developed to deal with “stock touting,” a practice that has existed as long as there have been stock markets, and that continues to occur to this day. Stock touting involves creating companies, and issuing stock in those companies based on false and/or misleading assets, information, or promise.

For example, Robb wrote about persons who created companies to build railroads in far parts of Great Britain, claiming that they possessed government guarantees that when the railroad was built, stockholders would be instantly wealthy. The stock sold quickly to speculators interested in making money, and the touters quickly disappeared, money in hand, with no railroad ever built. Such frauds aimed at unsuspecting speculators can be found in modern days as well. For example, the high-technology “bubble” of the 1990s resulted in the sale of stock in companies with much promise, but little if any underlying market value. When the bubble burst, stockholders were left holding shares in com-

panies that lacked any tangible assets. Compounding the problem, many stockholders had borrowed money using their stockholdings as collateral, leaving those unable to repay their debts bankrupt and their lenders taking losses as well. Robb noted that touting laws were enacted in reaction to such losses, and would be repeatedly repealed once the British Parliament decided that there was no longer a risk of such behaviors. Unfortunately, as soon as the laws were repealed, stock touts reappeared, new laws were created in response to their behaviors, and the cycle would continue over and over.

The Interstate Commerce Commission (ICC) Act of 1887 was enacted in the United States in response to the behaviors of the robber barons in the railroad industry. The robber barons, who included so-called reputable business leaders and politicians such as Leland Stanford, Sr., and Jay Gould, built railroads connecting the East and West Coasts of the United States, often without investing a cent of their own, and used their transportation monopoly to their own benefit. Before the passage of the ICC act, the railroad owners were free to set their own prices for transporting goods, often raising prices to the point that western farmers and ranchers could not make a profit on their goods. The ICC act created a commission that was meant to regulate the cost of interstate transportation of goods to guarantee that railroads would receive a fair income for their services, while farmers and ranchers would still be able to profit from their labors and goods.

The Sherman Antitrust Act of 1890 was enacted as a response to the growth of monopolies that threatened to destroy competition in the marketplace. A monopoly occurs when a producer controls an entire market for a product to the exclusion of others who would produce the product for a lesser cost. A monopoly allows the controlling producer to set any price for a product. A monopoly producer can set that price as high as she wants, with no fear of losing business due to competition from other producers. The Sherman Act was officially enacted because companies in various industry groups were attempting to eliminate their competition in the marketplace, thus hurting the economy.

It is noteworthy, however, that for the first decade of its existence, the Sherman Act was used almost exclusively as a tool to harass and criminalize the labor unions in their attempts to organize employees of those corporations which the act was

enacted to regulate. Other acts, such as the Clayton Antitrust Act of 1914, the Federal Trade Commission Act of 1914, the Robinson-Patman Act of 1936, the Cellar-Kefauver Act of 1950, and the Hart-Scott-Rodino Act of 1976, furthered attempts to shape and regulate unethical behaviors of business.

The Pure Food, Drug, and Cosmetic Act of 1906 served to rein-in industries that produced products that might endanger the welfare of Americans. Prior to this act, there were no enforceable regulation over food production in the United States. Authors, such as Upton Sinclair, in his novel *The Jungle*, exposed the abuses in the meatpacking industry. Also, prior to the passage of the act, poisons sold as drugs and cosmetics often had little or no positive effect; more likely having a significant negative effect on the health safety of consumers. The Sarbanes-Oxley Act of 2002 is a more recent attempt to respond to corporate criminal wrongdoing, requiring greater disclosure and accountability for corporate boards-of-trustees for the unethical and illegal behaviors of their executives and corporations.

The academic study of white-collar crime did not begin until Sutherland used the term *white-collar crime* in his presidential address before the American Sociological Society in 1939. In his 1949 book, *White-Collar Crime*, Sutherland presented the results of a study of white-collar crime offenses. During the next decade, a very limited amount of research on white-collar crime existed, primarily involving the definitional issues discussed previously. It was not until the publication of studies of the descriptions of behaviors defined as white-collar or corporate crimes, or Modus Operandi Studies as John Braithwaite (1985) has called them, that academic researchers renewed their interest in the topic.

These included studies such as Geis's research on the heavy electrical equipment scandal of the late 1950s and early 1960s; Quinney's (1963) study of prescription violations among pharmacists, and Diane Vaughan's (1983) investigation of the Revco prescription fraud scandal. These and similar research probes have given us a basic description of diverse white-collar and corporate crimes.

## THE ENCYCLOPEDIA

This reference, the *Encyclopedia of White-Collar & Corporate Crime*, is edited to incorporate information about a variety of white-collar crimes, and provides examples of persons, statutes, companies, and convictions. It is acknowledged that it does not, and cannot encompass all behaviors that may be defined as white-collar crimes. The articles have been written primarily for the college library, public library, and high-school library readers. Post-graduate academics and law firms may find the reference useful to add to their libraries. As such, the articles focus on the introductory knowledge that students can utilize.

The authors of the articles come from a variety of social science disciplines, although nearly all are current or retired academicians. The articles on laws describe the specific elements of the laws in terms of what types of illegal acts they are meant to apply to. Articles dealing individuals give a brief biographical sketch of the individual, but primarily focus on how they relate to the study of white-collar crime. Criminal events include descriptions of specific cases of white-collar crime, some very current, and others that were studied in the past. Both are relevant to our knowledge of white-collar crime. Some of the articles also deal with white-collar crime in countries other than the United States, to provide perspective that white-collar and corporate crime is hardly an American phenomenon.

As the definitions of white-collar and corporate crime remain somewhat fluid, we have included in this work other articles dealing with organized crime and prostitution, for example, which we acknowledge are not conventionally defined as white-collar crimes. However, elements of organized crime, prostitution, drug-trafficking, human-trafficking (for example) are addressed in this encyclopedia as these are criminal activities intertwined with white-collar crimes such as money-laundering, bribery, and government corruption.

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GENERAL EDITOR  
JUNE 2004





# Reader's Guide

This list is provided to assist readers in locating article entries on related topics. It classifies entries into 17 topical categories. Some entry titles appear in more than one category.

## **BUSINESS FRAUD & CRIMES**

Advertising Fraud  
Antitrust  
Arbitrage  
Bank Fraud  
Bankruptcy Fraud  
Bid Rigging  
Boycott  
Campaign Finance  
Canadian Mining Scandals  
Charity Fraud  
Cigarette Advertising  
Computer Hacking  
Copyright Infringement  
Corporate Criminal Liability  
Corporate Dumping  
Corporate Raiding  
Direct-Mail Fraud  
Economic Espionage  
Free Enterprise System  
Greenmail  
Hoarding  
Illegal Competition  
Industrial Espionage

## Interlocking Directorates

Kickbacks  
Labor Crimes  
Mail Fraud  
Insurance Fraud  
Internet Fraud  
Marketing Fraud  
Market Manipulation  
Outside Directors  
Partnership Fraud  
Patent Infringement  
Predatory Practices  
Price Discrimination  
Price Fixing  
Puffery  
Redlining  
Revolving Door  
Small-Business Fraud  
Tariff Crimes  
Tax Evasion  
Trademark Infringement  
Tying Arrangements  
Unfair Trade Practices  
Unions  
Wire Fraud

## **COMPANIES**

A. H. Robins  
AAMCO  
Adelphia Communications  
Allied Chemical  
Allied Irish Banks  
American Cyanamid  
American Hospital Supply  
American Motors  
Anheuser-Busch  
Archer Daniels Midland  
Arthur Andersen  
AT&T  
B. F. Goodrich  
Banco Ambrosiano  
Bank of Credit and Commerce  
International  
Banker's Trust  
Barings Bank  
BASF  
Beech Aircraft  
Beech-Nut Nutrition  
Board of Directors  
Bre-X  
Canadian Mining Scandals

Carl Karcher Enterprises  
 Cendant  
 Centennial Savings and Loan  
 Chem-Bio  
 Chevron  
 Conoco  
 Crédit Lyonnais  
 Daiwa Bank  
 Dow Chemical  
 Drexel Burnham Lambert  
 E. F. Hutton  
 Eli Lilly  
 Enron Corporation  
 Film Recovery Systems  
 Firestone Tires  
 Fisher-Price  
 Ford Motor Company  
 G. D. Searle  
 General Dynamics  
 General Electric  
 General Motors  
 Georgia Pacific  
 Global Crossing  
 Great Electrical Equipment  
   Conspiracy  
 Gulf Oil Corporation  
 IBM  
 Imperial Food Products  
 Investors Overseas Services  
 ITT  
 Johns-Manville  
 Kerr-McGee  
 Kidder, Peabody  
 Lloyds of London  
 Lockheed  
 Madison Guaranty  
 Merrill Lynch  
 Metallgesellschaft  
 Microsoft  
 Morgan Grenfell  
 Morton-Thiocol  
 National Medical Enterprises  
 NatWest Markets  
 Northrop Grumman  
 Owens Corning  
 Pharmaceutical Industry  
 Procter and Gamble, Inc.  
 Revco  
 Rite Aid  
 Rockwell International  
 Salomon Smith Barney

Standard Oil  
 Sumitomo  
 Teledyne Industries  
 Tyco International  
 Unisys  
 United American Bank  
 United Fruit  
 United States Steel  
 Waste Management, Inc.  
 WorldCom

### CONSUMERS

Advance Fee Scam  
 Age Discrimination  
 Automobile  
 Bait and Switch  
 Bank Fraud  
 Beech-Nut Nutrition  
 Bendectin  
 Better Business Bureaus  
 Breast Implants  
*Caveat Emptor*  
 Charity Fraud  
 Cigarette Advertising  
 Consumer Deaths  
 Contractor Fraud  
 Credit Card Fraud  
 Cyberstalking  
 Dalkon Shield  
 Direct-Mail Fraud  
 Fertility Fraud  
 Fisher-Price  
 Gambling and Lotteries  
 Identity Theft  
 Impersonation  
 Infant Formula  
 Public Citizen Health Research  
   Group  
 Tampons and Toxic Shock  
 Telemarketing Fraud  
 Tobacco Industry

### COUNTRIES & REGIONS

Africa  
 Arab Nations  
 Argentina  
 Asia  
 Australia  
 Brazil  
 Canada  
 Canadian Mining Scandals

Caribbean Islands  
 Central America  
 China  
 Cuba  
 Eastern Europe  
 France  
 Germany  
 Greece  
 Hong Kong  
 Indonesia  
 Ireland  
 Israel  
 Italy  
 Japan  
 Luxembourg  
 Mexico  
 Middle East  
 Poland  
 Russia  
 Saudi Arabia  
 Scandinavia  
 Singapore  
 South Africa  
 South America  
 Spain  
 Switzerland  
 Thailand  
 United Kingdom  
 United States

### CRIMINOLOGY & JUSTICE

Age Discrimination  
 Ancient Mercantile Crime  
 Art Fraud  
 Board of Directors  
 Bribery  
 Capitalism  
*Caveat Emptor*  
 Civil Forfeiture  
 Class-Action Lawsuits  
 Conflict Theory  
 Consequences of White-  
   Collar Crime  
 Conspiracy  
 Corporate Criminal Liability  
 Corruption  
 Crime Seriousness  
 Criminal Facilitation  
 Critical Theory  
 Differential Association  
 Drug Trafficking

Elite Crime  
 Ethics  
 Fear of Crime  
 Felony  
 Forensic Auditing  
 Forgery  
 Gender Discrimination  
 Global Warming  
 Globalization  
 Hartung-Burgess Debate  
 Human Trafficking  
 Investigation Techniques  
 Juries and Awards  
 Justice, Department of  
 Knapp Commission  
 Legal Malpractice  
 Military-Industrial Complex  
 Misappropriation Theory  
 Mollen Commission  
 Money Laundering  
 Multinational Corporations  
 National White-Collar  
   Crime Center  
 Negligence  
 Oligopoly  
 Organized Crime  
 Perjury  
 Police Brutality  
 Police Corruption  
 Political Assassinations  
 Pornography  
 Prosecution  
 Prostitution  
 Public Corruption  
 Racial Discrimination  
 Racketeering  
 Religious Fraud  
*Respondeat Superior*  
 Risk Analysis  
 Self-Control Theory  
 Sutherland-Tappan Debate  
 Techniques of  
   Neutralization

## **FINANCIAL & SECURITIES FRAUD**

Accounting Fraud  
 Arbitrage  
 Bad Checks  
 Banco Ambrosiano  
 Bank Fraud

Bank of Credit and Commerce  
   International  
 Banker's Trust  
 Bankruptcy Fraud  
 Barings Bank  
 Bendix Corporation  
 Boesky, Ivan  
 Bond Fraud  
 Centennial Savings and Loan  
 Check Kiting  
 Commodity Fraud  
 Counterfeiting  
 Credit Card Fraud  
 Currency Fraud  
 Debt Restructuring Fraud  
 Drexel Burnham Lambert  
 Embezzlement  
 Equity Funding Scandal  
 Extortion  
 Fiduciary Fraud  
 Flaming Ferraris  
 Insider Trading  
 Investment Trust Fraud  
 Nonprofit Organization Fraud  
 Offshore Bank Accounts  
 Offshore Entities  
 Savings & Loan Fraud  
 Securities Fraud  
 Stock Fraud  
 Teamsters Pension Fund  
 Vatican Bank

## **GOVERNMENT**

Bid Rigging  
 Bribery  
 Commodities Futures Trading  
   Commission  
 Corruption  
 Defense Industry Fraud  
 Environmental Protection  
   Agency  
 Federal Deposit Insurance  
   Corporation  
 Federal Trade Commission  
 Food and Drug Administration  
 Government Contract Fraud  
 Government Procurement  
   Fraud  
 Graft  
 HUD Scandals  
 Iran-Contra

Prisoners  
 Securities and Exchange  
   Commission  
 Sentencing Guidelines  
 Tailhook Scandal  
 Teapot Dome Scandal

## **LAWS**

Antitrust  
 Bank Secrecy Act  
 Boland Amendments  
 Campaign Finance  
 Celler-Kefauver Act  
 Clayton Antitrust Act  
 Clean Air Act  
 Clean Water Act  
 Comprehensive Thrift Act  
 Computer Fraud and  
   Abuse Act  
 Consumer Product Safety  
   Act  
 Ethics Reform Act  
 Fair Housing Act  
 False Claims Act  
 Federal Trade Commission Act  
 Financial Crime  
   Kingpin Statute  
 Foreign Corrupt Practices Act  
 Hart-Scott-Rodino Act  
 Hobbs Act  
 Insider Trading  
   Sanctions Act  
 Interstate Commerce Act  
 Major Fraud Act  
 Meat Inspection Act  
 Mining Safety and  
   Health Act  
 Occupational Carcinogens  
 Occupational Safety and  
   Health Act  
 Pure Food, Drug and  
   Cosmetics Act  
 Racketeer Influenced  
   Corrupt Organizations (RICO)  
 Robinson-Patman Act  
 Sherman Antitrust Act  
 Toxic Substances Control Act  
 Truth in Lending Act  
 Truth in Labeling  
 Witness and Victim  
   Protection Act

## **MEDICAL & HEALTHCARE FRAUD**

Age Discrimination  
 Baycol  
 Bendectin  
 Breast Implants  
 Dalkon Shield  
 Fertility Fraud  
 Healthcare Fraud  
 Health Corporation of America  
 Medical Malpractice  
 Medicare and  
     Medicaid Fraud  
 Pharmaceutical Industry  
 Research Fraud  
 Revco  
 Thalidomide  
 Unnecessary Surgery

## **PEOPLE**

Agnew, Spiro  
 Anderson, Jack  
 Bakker, Jim and Tammy  
 Benson, Michael L.  
 Boesky, Ivan  
 Braithwaite, John  
 Bush, George H. W.  
 Bush, George W.  
 Butcher Brothers  
 Capone, Alphonse  
 Carnegie, Andrew  
 Carson, Rachel  
 Carter, Jimmy  
 Clinard, Marshall  
 Clinton, William J.  
 Coffee, John C., Jr.  
 Cohen, Albert K.  
 Coleman, James W.  
 Coolidge, Calvin  
 Cressey, Donald  
 Cullen, Francis T.  
 Domhoff, G. William  
 Edelhertz, Herbert  
 Eisenhower, Dwight D.  
 Fisse, Brent  
 Ford, Gerald R.  
 Frankel, Martin  
 Geis, Gilbert  
 Giuliani, Rudy  
 Grant, Ulysses S.  
 Green, Mark J.

Holley, Louis Malcolm  
 Hoover, Herbert  
 Irving, Clifford  
 Jesilow, Paul  
 Jett, Joseph  
 Johnson, Lyndon B.  
 Keating Five  
 Keating, Charles  
 Kennedy, Robert F.  
 Leeson, Nick  
 Levi, Michael  
 Levine, Dennis  
 Madison, James  
 Maxwell, Robert  
 Milken, Michael  
 Morgan, J. P.  
 Nader, Ralph  
 Nixon, Richard M.  
 North, Oliver  
 Pontell, Henry  
 Reagan, Ronald  
 Rich, Marc  
 Roberts, Oral  
 Rockefeller, John D.  
 Roosevelt, Franklin D.  
 Roosevelt, Theodore  
 Ross, Edward  
 Rusnak, John  
 Short, James F. Jr.  
 Shover, Neal  
 Silkwood, Karen  
 Simpson, Sally  
 Sinclair, Upton  
 Sorkin, Ira  
 Spitzer, Elliot  
 Stanford, Leland, Sr.  
 Stavisky, Serge  
 Steffens, Lincoln  
 Stewart, Martha  
 Sutherland, Edwin H.  
 Truman, Harry S.  
 Vaughan, Diane  
 Weisburd, David  
 Wheeler, Stanton  
 Whistleblowers

## **POLITICAL SCANDALS**

ABSCAM  
 Anderson, Jack  
 Agnew, Spiro  
 Contra-Gate

Watergate  
 Whitewater

## **POLLUTION**

Air Pollution  
 Asbestos  
 Buffalo Creek  
 Exxon *Valdez*  
 Coal Mining  
 Global Warming  
 Globalization  
 Grassy Narrows  
 Greenpeace  
 Hazardous Waste  
 Kepone Scandal  
 Love Canal  
 Pesticides  
 Polyvinyl Chlorides  
 Three Mile Island  
 Times Beach  
 Waste Management, Inc.  
 Water Pollution

## **PRODUCTS**

Automobile  
 Baycol  
*Challenger* Disaster  
 Corvair  
 Dalkon Shield  
 Defective Products  
 Ford Pinto  
 Infant Formula  
 Oraflex  
 Product Deficiencies

## **REGULATION**

Air Pollution  
 Antitrust  
 Bank Fraud  
 Capitalism  
 Compliance Programs  
 Consent Agreements  
     and Orders  
 Federal Gambling Regulation  
 Financial Accounting  
     Standards Board  
 Free Enterprise System  
 National Association of  
     Securities Dealers  
 Reform and Regulation  
 Regulatory Enforcement

## SCAMS & SWINDLES

Advance Fee Scam  
 Art Fraud  
 Bad Checks  
 Bait and Switch  
 Better Business Bureaus  
 Bid Rigging  
 Bond Fraud  
 Charity Fraud  
 Computer Hacking  
 Consumer Product Safety  
   Commission Act  
 Contractor Fraud  
 Counterfeiting  
 Currency Fraud  
 Daisy Chains  
 Direct-Mail Fraud  
 Grifters

Home-Stake Swindle  
 Insurance Policy Churning  
 Nigerian 419  
 Ponzi Schemes  
 Real Estate Investments  
 Securities Fraud  
 Scams  
 Stock Churning  
 Sweepstakes Fraud

## WAR-PROFITEERING

American Civil War  
 American Revolution  
 Robber Barons  
 Vietnam War  
 War Crimes  
 World War I  
 World War II

## WORK-RELATED CRIMES

Age Discrimination  
 Asbestos  
 Brown Lung  
 Capitalism  
*Challenger* Disaster  
 Coal Mining  
 Employee Crimes  
 Employee Safety  
 Film Recovery Systems  
 Globalization  
 Industrial Revolution  
 Occupational. Carcinogens  
   Control Act  
*Ocean Ranger*  
 Sexual Harassment  
 Unsafe Working Conditions  
 Workplace Deaths



# Timeline

1473

One of the first pieces of legislation relating to the crime known today as embezzlement is enacted in England based on a crime known as the Carrier's Case, which involved the theft of bales of wool by an agent while transporting them to the coast.

1863

Congress enacts the False Claims Act; it is designed to deter fraud against the federal government by authorizing private citizens to file charges against any party attempting to collect payment from the government through fraudulent claims.

1880

The term *boycott* is originated, named after Charles Cunningham Boycott, whose ruthless evictions of tenants in Ireland provoked his employees so much they refused to have any dealings with him.

1881

Looking to supplement a federal trademark law passed in 1870, Congress passes the Trade-Mark Act, which allows trademark holders to sue for infringement of their trademarked product.

1886

A United States Supreme Court ruling in *Santa Barbara v. California* declares that a corporation is a nat-

ural person, that is, a corporation is guaranteed the same civil liberties that a person has bestowed upon him or her.

1890

The Sherman Antitrust Act provides a working definition of corporate crime, stating, "every contract, combination in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by a fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

1906

The federal government files a lawsuit against Standard Oil and John D. Rockefeller, claiming violation of the Sherman Antitrust Act. The case is debated all the way to Supreme Court, and in 1911 Standard Oil is divided into 34 smaller companies.

1906

President Theodore Roosevelt coins the term *muck-rakers*, referring to a group of journalists who were among the first to expose corruption in American

big business. He said of them, “[they have] provided American journalism with what many regard as one of its finest hours.”

1906

In response to Upton Sinclair’s concerns about the safety of America’s meat supply documented in *The Jungle*, coupled with issues pertaining to the quality of drugs being manufactured and the highly exaggerated claims proffered by the producers of health tonics, salves, and potions, Congress enacts The Pure Food and Drug Act. The act specifies that any meat products sold in interstate commerce had to be inspected by federal regulators.

1907

Edward Alsworth Ross introduces the concept of economic or financial crimes without giving evidence of the immensity of the offenses that exist at the time.

1898–1914

In the first five years following the enactment of the Sherman Antitrust Act, the U.S. Department of Justice only files nine cases relating to antitrust laws, and only 16 in the first 12 years.

Of the first 10 antitrust cases, the majority are filed against organized labor and labor organizer Samuel Gompers alleging restraint of trade by organizing strikes and boycotts. This was not the legislative intent of lawmakers stated in the Sherman Antitrust Act.

1914

The Federal Trade Commission Act is enacted. The act states that false advertising, which includes advertising facts that the advertiser has no reasonable basis to believe, regardless of future events that may prove the facts true, is an unfair and deceptive form of commerce.

1914

Due to the vague language in antitrust legislation, the U.S. Congress passes the Clayton Antitrust Act, supplementing and strengthening the Sherman Antitrust Act of 1890.

1920

The U.S. Congress passes the Truth in Fabric Act, designed to accurately display the type of fur or cloth the consumer is buying.

1924

Portuguese-born Arturo Alvez Reis uses forged government documents in order to deceive the British bank-note printer, Waterlow, into assuming that Alvez was executing an official government order. Alvez makes off with a high sum of Portuguese bank notes before the British authorities discover his intentions later that year.

1927

The U.S. Supreme Court upholds the previous ruling on the Teapot Dome Scandal, which declared the federal government’s leases on the Teapot Dome and Elk Hills oil reserves as “illegal and fraudulent.” Warren G. Harding, who was implicated in the scandal, is considered by many political historians to have been the worst president in U.S. history.

1931

Notorious gangster Al Capone, whose crimes extend far beyond the one he was imprisoned for, is convicted of income tax evasion, as the mafia boss kept no record of his finances.

1938

The U.S. Congress passes The Food, Drug, and Cosmetic Act, regulating cosmetics and therapeutic devices.

1939

Edwin Sutherland presents his presidential address to the American Sociological Society (ASS) meeting in Philadelphia, Pennsylvania. In the address, Sutherland, for the first time, describes *white-collar crime*, a term he has coined to describe the criminal activities of the upper-class and corporations.

1946

The Lanham Act, which lays the groundwork for all future trademark legislation, defines a trademark as “any word, name, symbol, device, or any combination thereof adopted by a manufacturer or merchants to identify goods and distinguish them from those manufactured or sold by others.”

1947

The first environmental law in the 20th century is passed. The Federal Insecticide, Fungicide and Rodenticide Act requires companies to register pesticides used in interstate commerce.

1949

Edwin Sutherland publishes the first edition of *White-Collar Crime*. In that book, he details the criminal behaviors of the 70 largest U.S. corporations at the time. He does not mention the names of the corporations out of apparent fear of reprisal. The 1983 third edition of the book, published 33 years after Sutherland's death, gives the names of the corporations studied for the first edition. He also theorizes that white-collar crime can be explained best by his theory of differential association, which assumes that all behaviors are learned behaviors.

1950

The Celler-Kefauver Act is passed, strengthening previous antitrust legislation by amending sections and adding provisions to the Clayton Antitrust Act of 1914.

1949–56

Telephone company AT&T is accused of antitrust laws by the Federal Communications Commission (FCC); the FCC's intention being the removal of AT&T subsidiaries Western Electric and Bell Laboratories from the company's system. AT&T agrees to a consent decree, allowing the company to keep control of the two subsidiaries but forbidding it to expand into other areas of communication.

1956

Congress passes the Federal Water Pollution Control Act. The act creates the Federal Water Pollution Control Administration, which approves and regulates new water quality standards.

1956

Facing mounting lawsuits by thousands of women claiming their children had been born with birth defects, pharmaceutical manufacturer Merrell Dow discontinues the production of Bendectin, a prescription drug that is used to alleviate morning sickness and nausea in pregnant women.

1959

The U.S. Senate begins committee hearings into allegations that the largest electrical equipment makers in the United States were conspiring to fix prices. Among the manufacturers were major providers General Electric, Westinghouse, Allis Chalmers, and Federal Pacific Electric.

1960

Congress investigates the meatpacking industry; reports conclude that about 15 percent of all commercially slaughtered animals and about 25 percent of all commercially prepared meat products were not examined by USDA investigators because the meat was only distributed within the slaughtering and packing plant's state.

1960

The International Brotherhood of Teamsters Pension Fund managers loan money from the fund to organized criminals, usually through straw men, for casinos, hotels, and resorts. The recipients of the fund "proceeds" included such noteworthy establishments as Rancho La Costa, Circus Circus, Caesar's Palace, the Dunes, and the Sands.

1957–61

Multinational conglomerate General Electric, Westinghouse, and other manufacturers of heavy electrical equipment are convicted of price-fixing and other charges for electrical equipment valued at \$1.74 billion per year. It is the largest price-fixing case in the history of the Sherman Antitrust Act at that time. This is the first time that individual white-collar criminals are jailed for their offenses. GE's fine is equivalent to a person earning \$175,000 per year having to pay a \$3 parking ticket.

1962

United States Steel Corporation is accused of violations of the Sherman Antitrust Act, issuing building loans that stipulate the builder/borrower must use materials purchased from the steel corporation at artificially high prices.

The case is tried in the Supreme Court three times before a February 1977 ruling stated that the corporation did not violate antitrust laws.

1962

The U.S. Congress passes the Kefauver Harris Drug Amendments, requiring that drug companies show evidence their products were safe to a relative degree.

1965

The United States Congress passes the Federal Cigarette Labeling and Advertising Act, requiring the surgeon general's health warnings on all cigarette packages.



1966

The U.S. Congress passes the National Traffic and Motor Vehicle Safety Act in mandating the incorporation of safety devices that were designed to prevent as many fatalities as possible in automobile accidents. During the next six years, automobile accidents decline at an average rate of 3.5 percent annually. The act also established the National Highway Traffic Safety Administration under the Department of Transportation to oversee safety and consumer programs, including motor vehicle crash testing and automotive recalls.

1968

The U.S. Congress passes the Truth in Lending Act, designed to promote economic stability by protecting the credit rights of consumers. No longer, the act says, will consumers be subject to fine print and misleading credit applications.

1970

Ford Motor Corporation unveils its new automobile, the Pinto, despite tests revealing that rear-end collisions sometimes caused fuel-line ruptures, setting the vehicle aflame.

1970

In response to rising concerns about worker and workplace safety, the U.S. Congress passes the Occupational Safety and Health Act. Enacted under the federal government's Constitutional right to regulate interstate commerce, the legislation aimed to guarantee that workers across the country have a workplace that is free from unreasonable dangers.

1970

In response to growing concern for the environment, the Clean Air Act (CAA), first passed in 1970 and amended substantially in 1990, introduced a set of guidelines requiring states to regulate sources of air pollution to specific air quality requirements, and to have regulatory programs in order to attain improved levels of air quality.

1971

The U.S. Congress bans all broadcast advertising related to cigarettes.

1972

The Consumer Product Safety Act is enacted as a response to perceptions that product liability laws

did not sufficiently protect consumers from unsafe products. To implement the act, the Consumer Product Safety Commission was created. The Commission was responsible for administering additional consumer protection laws, including the Federal Hazardous Substances Act and the Flammable Fabrics Act.

1976

Amending the Clayton Act of 1914, Congress passes the Hart-Scott-Rodino Antitrust Improvements Act, requiring that certain proposed mergers of assets be approved beforehand by the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice.

1976

The Toxic Substances Control Act is signed into law by the U.S. Congress and directs the administrator of the Environmental Protection Agency (EPA) to establish testing procedures for toxic chemicals, publicize results of chemicals that prove to be dangerous, and to set guidelines for controlling toxic chemicals.

1977-79

The Federal Bureau of Investigation conducts a sting operation in which agents pretend to be wealthy Arab sheiks seeking investment opportunities in the United States. Seven legislators, including a Senator and six Congressional representatives are videotaped accepting bribes from these agents in return for political favors. The scandal comes to be known as ABSCAM, after the bogus Abdul Enterprise company.

1980

Marshall Clinard's book, *Corporate Crime*, reveals that between 1975 and 1976 the country's 582 largest corporations had violated the law a total of 1,553 times.

1980

The Equal Employment Opportunity Commission issues a set of guidelines detailing prohibited sexual behavior that applies to all federal agencies and to private businesses with 15 or more employees

1981

Three General Electric executives are imprisoned over a payment of \$1.25 million to a Puerto Rican

official to obtain contracts to a federally owned electrical plant.

1984

Ten thousand workers and townspeople are killed after one of Union Carbide's India-based plant releases liquid methyl isocyanate, a harmful gaseous chemical, after allowing a number of their products to rust and decay.

1984

A Louisiana hospital requires that all surgical patients use the services of one of four anesthesiologists. A competing anesthesiologist charged that this violated the Sherman Antitrust Act. The U.S. Supreme Court's 1984 decision that this case did not represent an illegal tying arrangement was based on the hospital's lack of dominant position; it only housed 30 percent of area hospitalized patients.

1976-85

A report by the U.S. General Accounting Office reveals that 51.5 percent of all drugs introduced had to be relabeled because of serious adverse reactions found after the marketing of these drugs.

1980-86

Teledyne Hydra-Power, a unit of Teledyne Industries, defrauds the U.S. Navy of \$4.5 million on a helicopter contract by inflating the price of parts and hours worked.

1988

The Major Fraud Act is signed into law by President Ronald Reagan, significantly increasing the maximum penalties that could be assessed for certain economic frauds committed against the U.S. government.

1988

Congress updates the Lanham Act with the Trademark Law Revision Act, changing the period of trademark protection from 20 years to 10 years, with infinite renewals. The act also stipulates that after five years, the trademark holder is required to file an affidavit showing that the trademark will continue to be used.

1989

The U.S. government brings criminal charges against Charles Keating for fraud, racketeering and

conspiracy, and the government takes control of Lincoln Savings and Loan.

1989

The U.S. Public Interest Research Group reports that oil company Chevron's operations in the Gulf of Mexico have a less-than-admirable safety record. The research firm reported that between 1956 and 1989, offshore rigs operated by Chevron had experienced 10 gas blowouts, 65 fires and explosions, 40 pollution incidents, and 5 pipeline breaks or leaks.

1989

A study by research firm Essential Information reports that between 1984 and 1989, Chevron had spilled a total of 2.8 million gallons of oil, making it the world's largest and most consistent spiller of oil.

1989

Talk show televangelist Jim Bakker is convicted of fraudulently raising more than \$158 million. A 28-page indictment included 8 counts of mail fraud, 15 counts of wire fraud use of telephone and television, and 1 count of conspiracy to commit wire and mail fraud.

1989

U.S. multinational corporation Union Carbide settles out of court for \$480 million with the families of victims involved in a 1984 chemical spill.

1990

The U.S. Congress passes the Nutrition Labeling and Education Act of 1990, requiring all packaged foods to carry labels with nutrition information.

1990

Problems, including bribery and mispricing, involving General Electric become so pervasive that the Pentagon's Defense Contract Management Agency takes the unique step of setting up a special investigations office just for the company. The office secures 22 criminal indictments against the company, its subcontractors and employees, and recovers \$221.7 million.

1980-90

Legislation is enacted to curb redlining, a process in which real estate agents and insurance companies exclude certain socioeconomic groups and/or races

from certain neighborhoods. Such acts include the Home Ownership Protection Act, the Community Reinvestment Act, and the Home Mortgage Disclosure Act.

1991

Twenty-five employees are killed in a fire in an Imperial Food Products Incorporated chicken processing plant. The employees were unable to escape the flames due to the exit doors being locked due to management fear of employee theft.

1991

Investment company Solomon Smith Barney's telecom research analyst Jack Grubman falsifies company reports to make certain companies appear healthier than they actually were, causing a number of investors to lose substantial amounts of money.

1992

A lagged time-series analysis of price-fixing offenses between 1890 and 1988 finds no significant relationship between price-fixing enforcement and political and economic variables. The study is the only long-term longitudinal study of price-fixing.

1997

Camel Cigarette Corporation drops its famous Joe Camel advertising campaign amid mounting lawsuits that claimed the cigarette-smoking cartoon character featured on posters was marketed toward children, a demographic that could not legally purchase the product.

1990–2000

The Financial Action Task Force (FATF) calculates that approximately \$500 billion is processed in money laundering operations around the world each year.

2000

Owens Corning, which sells industrial pipe insulation, is driven to bankruptcy by the settlement of over 243,000 asbestos-related claims.

2001

An Italian court acquits former chemical company managers of charges that stemmed from a 10-year period in which 150 workers died from exposure to a harmful chemical. The managers were acquitted because the company was not aware of the harmful

effects of the chemical until after the workers were contaminated.

1990–2002

General Electric is involved in 63 court cases brought against it by the federal government. The sum of the settlements reaches \$982 million.

2002

The Securities and Exchange Commission files a lawsuit against former executives of Waste Management, Inc., accusing them of inflating earnings by almost \$2 million.

2002

John J. Rigas of Adelphia Communications, a cable company based in a small rural town, is accused by the federal government of concealing \$2.3 billion in debt from investigators and Adelphia Communications shareholders.

2002

In response to the growing amount of stock fraud cases, Congress passes the Sarbanes-Oxley Act, creating a series of oversight measures, and expanded and increased the sanctions for illicit white-collar actions.

1980–2003

Millions of Americans are affected by advanced fee fraud associated with African-based criminal groups. Advanced fee fraud involves a promise of a large amount of money given to the participant if the participant details personal banking information to the foreign-based entity.

2003

A study estimates that the common practice of price fixing may cost the American public as much as \$78 billion per year.

2004

Media tycoon Martha Stewart is convicted of lying to cover up possible insider trading. Critics accuse prosecutors of zealously showcasing the Stewart case as an example of how rich and famous white-collar criminals are now being pursued and prosecuted by the U.S. government.



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# List of Articles

## A

A. H. Robins  
AAMCO  
ABSCAM  
Accounting Fraud  
Adelphia Communications  
Advance Fee Scam  
Advertising Fraud  
Africa  
Age Discrimination  
Agnew, Spiro T.  
Air Pollution  
Allied Chemical  
Allied Irish Banks  
American Civil War  
American Cyanamid  
American Hospital Supply  
American Motors  
American Revolution  
Ancient Mercantile Crime  
Anderson, Jack  
Anheuser-Busch  
Antitrust  
Arab Nations  
Arbitrage  
Archer Daniels Midland  
Argentina  
Art Fraud  
Arthur Andersen

Asbestos  
Asia  
AT&T  
Australia  
Automobile

## B

Bad Checks  
Bait-and-Switch  
Bakker, Jim and Tammy  
Banco Ambrosiano  
Bank Fraud  
Bank of Credit and Commerce  
International  
Bank Secrecy Act  
Banker's Trust  
Bankruptcy Fraud  
Barings Bank  
BASF  
Baycol  
Beech Aircraft  
Beech-Nut Nutrition  
Bendectin  
Bendix Corporation  
Benson, Michael L.  
Better Business Bureaus  
B. F. Goodrich  
Bid Rigging  
Board of Directors

Boesky, Ivan  
Boland Amendment  
Bond Fraud  
Boycott  
Braithwaite, John  
Brazil  
Breast Implants  
Bre-X  
Bribery  
Brown Lung  
Buffalo Creek  
Bush, George H. W.  
Bush, George W.  
Butcher Brothers

## C

Campaign Finance  
Canada  
Canadian Mining Scandals  
Capitalism  
Capone, Alphonse  
Caribbean Islands  
Carl Karcher Enterprises  
Carnegie, Andrew  
Carson, Rachel  
Carter, James E.  
*Caveat Emptor*  
Celler-Kefauver Act  
Cendant

Centennial Savings and Loan  
Center for Science in the Public  
Interest  
Central America  
*Challenger* Disaster  
Charity Fraud  
Check Kiting  
Chem-Bio  
Chevron  
China  
Cigarette Advertising  
Civil Forfeiture  
Class-Action Lawsuits  
Clayton Antitrust Act  
Clean Air Act  
Clean Water Act  
Clinard, Marshall  
Clinton, William J.  
Coal Mining  
Coffee, John C., Jr.  
Cohen, Albert K.  
Coleman, James W.  
Commodities Fraud  
Commodity Futures Trading  
Commission  
Compliance Programs  
Comprehensive Thrift Act  
Computer Fraud and Abuse Act  
Computer Hacking  
Conflict Theory  
Conoco  
Consent Agreements, Decrees,  
and Orders  
Consequences of White-  
Collar Crime  
Conspiracy  
Consumer Deaths  
Consumer Product  
Safety Act  
Contractor Fraud  
Contra-Gate  
Coolidge, Calvin  
Copyright Infringement  
Corporate Criminal Liability  
Corporate Dumping  
Corporate Raiding  
Corruption  
Corvair  
Counterfeiting  
Credit Card Fraud  
Crédit Lyonnais

Cressey, Donald  
Crime Seriousness  
Criminal Facilitation  
Critical Theory  
Cuba  
Cullen, Francis T.  
Currency Fraud  
Cyberstalking

**D**

Daisy Chains  
Daiwa Bank  
Dalkon Shield  
Day Fines  
Debt Restructuring Fraud  
Defective Products  
Defense Industry Fraud  
Differential Association  
Direct-Mail Fraud  
Domhoff, G. William  
Dow Chemical  
Drexel Burnham Lambert  
Drug Trafficking

**E**

E. F. Hutton  
Eastern Europe  
Economic Espionage  
Edelhertz, Herbert  
Eisenhower, Dwight D.  
Eli Lilly  
Elite Crime  
Embezzlement  
Employee Crimes  
Employee Safety  
Enron Corporation  
Environmental Protection Agency  
Equity Funding Scandal  
Ethics  
Ethics Reform Act  
Extortion  
Exxon *Valdez*

**F**

Fair Housing Act  
False Claims Act  
Fear of Crime  
Federal Deposit Insurance  
Corporation  
Federal Gambling Regulation  
Federal Trade Commission

Federal Trade Commission Act  
Felony  
Fertility Fraud  
Fiduciary Fraud  
Film Recovery Systems  
Financial Accounting Standards  
Board  
Financial Crime  
Kingpin Statute  
Firestone Tires  
Fisher-Price  
Fisse, Brent  
Flaming Ferraris  
Food and Drug Administration  
Ford Pinto  
Ford, Gerald R.  
Foreign Corrupt Practices Act  
Forensic Auditing  
Forgery  
France  
Frankel, Martin  
Free Enterprise

**G**

G. D. Searle  
Gambling and Lotteries  
Geis, Gilbert  
Gender Discrimination  
General Dynamics  
General Electric  
General Motors  
Georgia Pacific  
Germany  
Giuliani, Rudolph  
Global Crossing  
Global Warming  
Globalization  
Government Contract Fraud  
Government Procurement Fraud  
Grabosky, Peter  
Graft  
Grant, Ulysses S.  
Grassy Narrows  
Great Electrical Equipment  
Conspiracy  
Greece  
Green, Mark J.  
Greenmail  
Greenpeace  
Grifters  
Gulf Oil Corporation

**H**

Hart-Scott-Rodino Act  
 Hartung-Burgess Debate  
 Hays, Wayne  
 Hazardous Waste  
 Healthcare Fraud  
 Hoarding  
 Hobbs Act  
 Holley, Louis Malcolm  
 Home-Stake Swindle  
 Hong Kong  
 Hoover, Herbert  
 HUD Scandals  
 Human Trafficking  
 Hyde, Edward

**I**

IBM  
 Identity Theft  
 Illegal Competition  
 Imperial Food Products  
 Impersonation  
 Indonesia  
 Industrial Espionage  
 Industrial Revolution  
 Infant Formula  
 Insider Trading  
 Insider Trading  
     Sanctions Act  
 Insurance Fraud  
 Interlocking Directorates  
 Internet Fraud  
 Interstate Commerce Act  
 Investigation Techniques  
 Investment Trust Fraud  
 Investors Overseas Services  
 Iran-Contra Scandal  
 Ireland  
 Irving, Clifford  
 Israel  
 Italy  
 ITT

**J**

Japan  
 Jesilow, Paul  
 Jett, Joseph  
 Johns-Manville  
 Johnson, Lyndon B.  
 Juries and Awards  
 Justice, Department of

**K**

Keating, Charles  
 Keating Five  
 Kennedy, Robert F.  
 Kepone Scandal  
 Kerr-McGee  
 Kickbacks  
 Kidder, Peabody  
 Knapp Commission

**L**

Labor Crimes  
 Leeson, Nick  
 Legal Malpractice  
 Levi, Michael  
 Levine, Dennis  
 Lloyd's of London  
 Lockheed  
 Love Canal  
 Luxembourg

**M**

Madison Guaranty  
 Mail Fraud  
 Major Fraud Act of 1988  
 Maritime Fraud  
 Market Manipulation  
 Marketing Fraud  
 Maxwell, Robert  
 Meat Inspection  
     Act of 1906  
 Medical Malpractice  
 Medicare and  
     Medicaid Fraud  
 Merrill Lynch  
 Metallgesellschaft  
 Mexico  
 Microsoft  
 Middle East  
 Military-Industrial Complex  
 Milken, Michael  
 Mining Safety and  
     Health Act  
 Misappropriation Theory  
 Mollen Commission  
 Money Laundering  
 Morgan Grenfell  
     Asset Management  
 Morgan, J. Pierpont  
 Morton-Thiocol  
 Multinational Corporations

**N**

19th-Century Regulation  
 Nader, Ralph  
 National Association of  
     Securities Dealers  
 National Highway Traffic  
     Administration  
 National Medical Enterprises  
 National White-Collar  
     Crime Center  
 NatWest Markets  
 Negligence  
 Nigerian 419  
 Nixon, Richard M.  
 Nonprofit Organization Fraud  
 North, Oliver  
 Northrop Grumman

**O**

Obstruction of Justice  
 Occupational Carcinogens  
 Occupational Crime  
 Occupational Safety  
     and Health Act  
*Ocean Ranger*  
 Offshore Bank Accounts  
 Offshore Entities  
 Oil Crimes  
 Oligopoly  
 Oralex  
 Organized Crime  
 Outside Directors  
 Owens Corning

**P**

Patent Infringement  
 Pension Funds  
 Perjury  
 Pesticides  
 Pharmaceutical Industry  
 Poland  
 Police Brutality  
 Police Corruption  
 Political Assassination  
 Polyvinyl Chlorides  
 Pontell, Henry N.  
 Ponzi Schemes  
 Pornography  
 Predatory Practices  
 Price Discrimination  
 Price Fixing



Prisoners  
Procter & Gamble  
Product Liability  
Prosecution  
Prostitution  
Public Citizen Health Research Group  
Public Corruption  
Puffery  
Pure Food, Drug and Cosmetics Act

## R

Racial Discrimination  
Racketeering  
Racketeer Influenced Corrupt Organizations  
Reagan, Ronald  
Real Estate Fraud  
Redlining  
Reform and Regulation  
Regulatory Enforcement  
Religious Fraud  
Research Fraud  
*Respondeat Superior*  
Revco  
Revolving Door  
Rich, Marc  
Risk Analysis  
Rite Aid  
Robber Barons  
Roberts, Oral  
Robinson-Patman Act  
Rockefeller, John D.  
Rockwell International  
Roosevelt, Franklin D.  
Roosevelt, Theodore  
Ross, Edward  
Rostenkowski, Daniel  
Rusnak, John  
Russia

## S

Salomon Smith Barney  
Saudi Arabia  
Savings and Loan Fraud

Scams  
Scandinavia  
Securities and Exchange Commission  
Securities Fraud  
Self-Control Theory  
Sentencing Guidelines  
Sexual Discrimination  
Sexual Harassment  
Sherman Antitrust Act  
Short, James F., Jr.

Shover, Neal  
Silkwood, Karen  
Simpson, Sally  
Sinclair, Upton  
Singapore  
Small-Business Fraud  
South America  
Spain  
Spitzer, Elliot  
Sports Scandals  
Standard Oil  
Stanford, Leland, Sr.  
Stavisky, Serge  
Steffens, Lincoln  
Stewart, Martha  
Stock Churning  
Stock Fraud  
Sumitomo Corporation  
Sutherland, Edwin H.  
Sutherland-Tappan Debate  
Sweepstakes Fraud  
Switzerland

## T

Tailhook Scandal  
Tampons and Toxic Shock  
Tariff Crimes  
Tax Evasion  
Teamsters Pension Fund  
Teapot Dome Scandal  
Techniques of Neutralization  
Teledyne Industries  
Telemarketing Fraud  
Thailand  
Thalidomide

Three Mile Island  
Times Beach  
Tobacco Industry  
Toxic Substances Control Act  
Trademark Infringement  
Truman, Harry  
Truth in Labeling  
Truth in Lending Act  
Tyco International  
Tying Arrangements

## U

Unfair Trade Practices  
Unilever  
Union Carbide  
Unions  
Unisys  
United American Bank  
United Fruit  
United Kingdom  
United States  
Unnecessary Surgery  
*Unsafe at Any Speed*

## V

Vatican Bank  
Vaughan, Diane  
Vietnam War

## W-Z

Wage Crimes  
War Crimes  
Waste Management, Inc.  
Water Pollution  
Watergate  
Weisburd, David  
Wheeler, Stanton  
Whistleblowers  
Whitewater  
Wire Fraud  
Witness and Victim Protection Act  
Workplace Deaths  
Workplace Violence  
World War I  
World War II  
WorldCom



# A

## A. H. Robins

IN 1997, more than 25 years after A. H. Robins introduced the Dalkon Shield intrauterine device (IUD) as a safe, effective contraceptive, the last of the product liability suits against the company were headed for court. In the intervening years, at least 20 deaths and 200 miscarriages had been caused by the Dalkon Shield; 235,000 women attributed pelvic infections, often leading to infertility, to their use of the product. The Shield had been on the market in the United States for less than four years, from January 1971 to June 1974.

Marketed by A. H. Robins as a safer, more effective alternative to oral contraceptives, the Dalkon Shield was essentially an untested device with unknown effects. At the time, the U.S. Food and Drug Administration (FDA) required advance testing and approval only for drugs, not for medical devices. Since IUDs are presumed to work by irritating the uterus in a woman, thus preventing fertilized eggs from implanting there, they qualified as contraceptive devices.

Although A. H. Robins included copper in the Dalkon Shield in hope of an additional contraceptive effect, and mentioned this in their marketing to doctors, the company downplayed the importance of the copper in its reports to the FDA so that the Shield would not be reclassified as a drug.

Such testing as the company relied upon was inadequate and misrepresented. The original clinical trial by Dr. Hugh Davis, inventor of the Shield and shareholder in the Dalkon Company bought by Robins, claimed a 1.1 percent pregnancy rate, with few side effects or spontaneous rejections of the Shield. Later reviews of Davis's study argued that his testing period was insufficient, his sample too small, and his procedures gravely flawed. The Shield was also significantly redesigned by A. H. Robins, making Davis's results meaningless. Results from a later 10-clinic study, touted by A. H. Robins as the "Cadillac" of clinical studies, were largely concealed from the public. In an internal company report quoted by Minneapolis, Minnesota, investigative reporters Susan Perry and Jim Dawson, project coordinator Dr. Ellen Preston noted that studies would be funded only if they were "known in advance to be favorable." Lacking such studies, Robins continued to use the 1.1 percent figure in its marketing, even though independent researchers put the pregnancy rate as high as 5 percent and argued that the Shield's rejection rate and side effects were worse than those of other IUDs.

The falsely low pregnancy rate attributed to the Shield left doctors and patients unprepared for the device's high risk of a second-trimester septic abortion. A. H. Robins initially instructed doctors not to remove the Shield from women who became

pregnant, as attempting to remove the device was likely to cause a miscarriage. However, doctors discovered that leaving it in almost always led to life-threatening infections at the 20th week of the pregnancy. It was at this point that expansion of the uterus pulled the IUD's tail string into the ordinarily sterile womb.

The Dalkon Shield's tail string was unusual among IUDs in being a multifilament string in which bacteria, ordinarily present in the vagina, could lodge between the filaments and wick upward into the womb. Internal memos indicate that A. H. Robins's management knew about the potential for this problem before the device went to market but were more concerned about how the stiff string might irritate men during intercourse. One manager at the Chap Stick factory, where tails were attached to Shields, pointed out the wicking problem and noted that the attachment process damaged the tails in ways that increased the likelihood of bacteria reaching the womb. He was fired.

The result of wicking was a virtual epidemic of pelvic inflammatory disease (PID) among Dalkon Shield wearers. Bacteria gained a foothold in the womb's irritated lining, initially causing low-grade infections that were often mistaken for flu. A serious outbreak of PID, however, could be life-threatening, and untreated PID typically results in infertility.

Although doctors reported these illnesses and patients' difficulty tolerating the Shield to A. H. Robins, company management insisted that they were not aware of significant problems with the Dalkon Shield. In June 1973, after the company had received warnings even from doctors involved in its early aggressive promotion of the Shield, A. H. Robins executives testified to a House Government Operations subcommittee that the device was entirely safe. A year later, swamped with product liability suits from injured women, A. H. Robins stopped selling the Shield in the United States, though it continued sales in the developing world.

As the FDA scheduled hearings on whether IUDs were safe, A.H. Robins executives hurried to destroy files that would show they knew the dangers of their product. An attack of conscience by Roger Tuttle, the lawyer in charge of A. H. Robins's Dalkon Shield litigation, resulted in his secretly preserving some of the most incriminating documents. He produced these documents on behalf of Dalkon Shield plaintiffs in 1984. The first major product li-

ability lawsuit against A. H. Robins went to trial in Kansas in 1974; a jury awarded Connie Deemer \$10,000 in compensatory damages and \$75,000 in punitive damages for harms caused by her Dalkon Shield embedding in her uterus.

Dalkon Shield litigation was about to become big business, led by attorneys Michael Ceresi and Dale Larson of Minneapolis law firm Robins, Zelle, Larson and Kaplan, with a seminal series of trials taking place before flamboyant Minnesota judge Miles Lord. A. H. Robins's attorneys attempted to discourage lawsuits by grilling plaintiffs about their sexual history, bathroom habits, and even whether they wore pantyhose. None of these factors were ever shown to have any relationship to PID or other harms attributed to the Shield.

A. H. Robins attempted to limit its liability by declaring bankruptcy under a Chapter 11 restructuring in August 1985. The restructuring plan, administered by Judge Robert Merhige in the company's home jurisdiction of Richmond, Virginia, ultimately set up a \$2.35 billion trust to pay claimants. Richard Sobol's history of the bankruptcy argues that Robins manipulated the process to minimize the number of claimants and to delay payments so long that many injured women were too old to use their settlements to pay for fertility treatments. Certainly, in 1991, six years after the initial filing, women were complaining that settlements were too slow and too small. Meanwhile, A. H. Robins denounced its external legal counsel for over-billing the company.

Sobol notes that A. H. Robins's reorganization plan included provisions that plaintiffs could not sue third parties, such as the individual A.H. Robins executives who had approved the company's handling of the Dalkon Shield. This injunction was probably an incentive for American Home Products, now renamed Wyeth, to purchase the bankrupt company in 1988.

Thanks in part to the Dalkon Shield tragedy, the FDA gained, in 1976, the authority to require testing and approval of medical devices. The first IUD they approved, G.D. Searle's Copper-7, became a focus of similar litigation in the mid-1980s. In 1991, Dr. Richard A. Krommal, who had been a consultant for A. H. Robins on the Dalkon Shield, published a reanalysis of his own study data, arguing that the risks of IUDs had been overstated by other researchers. As of late 2003, Planned Parenthood was promoting IUDs as "the most inexpensive long-

term reversible method of contraception available in the world.” Wyeth does not currently market IUDs.

#### SEE ALSO

Dalkon Shield; consumer deaths; defective products.

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## AAMCO

PERHAPS IRONICALLY for a company that stresses trust in its advertising, this 700-shop transmission repair franchise has a 35-year history of defrauding consumers with unneeded overhauls and unhonored warranties.

Founded by high school drop-out Anthony A. Martino in 1959 as a shop that specialized in repairing the newly available automatic transmissions, AAMCO went national as a franchise in 1962 with the help of franchising expert—and later company president—Robert Morgan. As with many franchise operations, AAMCO’s ideal franchisee was not a shop owner with relevant technical skills, but an energetic, inexperienced entrepreneur who was willing to learn a system. Arthur Glickman reports in *Mr. Badwrench* that AAMCO actively sought non-mechanics to operate its franchises. The

AAMCO system emphasized bringing customers in with promised low prices, then selling higher-priced services. A sales manual from the late 1960s, about the time that Morgan bought out Martino, is quoted by Glickman as stating: “It is AAMCO’s policy that the purchase of an AAMCO custom rebuilt transmission be suggested to every customer who enters your shop.”

By 1970, AAMCO franchisees had followed these instructions so thoroughly that the parent company had to sign a consent agreement with the Federal Trade Commission (FTC) promising no more deceptive advertising or bait-and-switch sales tactics. Fourteen months later, AAMCO admitted to 233 violations of this order. Over the next 15 years, a series of undercover investigations in 17 states found that AAMCO shops consistently sold unneeded, and sometimes unperformed, transmission rebuilds. These investigations culminated in a 1987 14-state settlement in which AAMCO promised to implement a “secret shopper” program that would prevent individual AAMCO shops from inflating repair costs.

The most common complaint against AAMCO was that customers whose cars needed minor repairs were sold a complete transmission rebuild or replacement, with a lifetime warranty, at a cost about eight times that of the needed work. Methods of motivating car owners to pay for extensive transmission work ranged from the classic “metal shavings in the pan”—promoting a common, harmless condition as cause for alarm—to showing customers damaged parts from other transmissions kept for the deceptive purpose.

Many customers complained later that their transmissions were in worse shape after the repairs than before, and that AAMCO attempted to charge for additional repairs rather than honoring their warranties. Complained Anita Rubin, who bought the lifetime warranty for her five-year-old truck only to have AAMCO fail to fix it four times, to the *New York Times*: “What are they advertising? It doesn’t say it’s a lifetime warranty as long as it doesn’t break down.”

By 1989, some AAMCO franchisees were so frustrated that they considered filing a class action lawsuit against the company, alleging that the company failed to provide technical support and harassed franchisees who refused to sell unneeded repairs to consumers. The matter was settled out of court.

AAMCO continues to offer customers the option of buying a lifetime warranty on transmissions. The corporate internet site boasts that CEO Keith Morgan, son of Robert Morgan, has since 1992 led the company to its highest profits ever.

#### SEE ALSO

advertising fraud; bait and switch; scams; Better Business Bureau.

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## ABSCAM

THE ABSCAM scandal involved a Federal Bureau of Investigation (FBI) sting operation conducted during the late 1970s in which members of Congress and other prominent political figures were videotaped accepting financial bribes from agents posing as Arabian sheiks. In all, seven legislators including a senator and six Congressional representatives from five different states were convicted, fined and/or imprisoned for accepting cash or stock bribes in return for political favors.

The ABSCAM (which is short for Abdul Scam and named after the bogus Abdul Enterprise company) operation began in 1978 when FBI agents working with a convicted swindler, Melvin Weinberg, created a fraudulent Arabian company, Abdul Enterprises Limited, on Long Island, New York. The fictitious company was set up to represent imaginary and wealthy Arabs, Kambir Abdul Rahman and Yassir Habib, who were interested in investing in the United States.

Weinberg was designated the chairman of the company. Once established, agents quickly spread word about the two wealthy Arab businessmen and their intentions to engage in shrewd business transactions. As part of the operation, the FBI deposited

\$1 million at the Chase Manhattan Bank in the name of Abdul Enterprises to give the false company instant credibility. Originally, the operation was established to focus on business officials accepting bribes or engaging in other fraudulent practices. For instance, the fictitious Arabs engaged in several scrupulous deals with individuals selling stolen securities, art, and forgers of certificates of deposit. However, by the fall of 1978, the ABSCAM operation ventured into the political arena that involved bribes of federal and state officials.

A group that had sold Abdul Enterprises phony certificates of deposit suggested that the wealthy Arabs should establish a casino in New Jersey. This forger group offered to introduce the fictitious Arabs to a New Jersey politician who could guarantee a state gambling license. The politician was Angelo Errichetti who was the mayor of Camden, New Jersey. Shortly after their initial meeting with Errichetti, Abdul Enterprises was able to bribe the vice-chairman of the New Jersey Casino Commission, Kenneth MacDonald, concerning the approval of the gambling license. By the spring of 1979, Errichetti provided undercover FBI agents with a written list of federal and state politicians in New Jersey and the surrounding areas who were willing to engage in similar corrupt relationships. Errichetti indicated that these politicians were open to bribes concerning construction related issues, such as zoning waivers and building permits. In other instances, Errichetti arranged meetings between two Philadelphia lawyers, Howard Criden and Ellis Cook, and the Arab sheiks who expressed interest in gaining political asylum.

The Congressional bribery stage of ABSCAM operation occurred in July 1979 when Errichetti arranged a meeting between associates of Kambir Abdul Rahman, one of the fictitious Arab businessmen, and two Democratic representatives from Pennsylvania, Ozzie Myers and Raymond Lederer. In particular, the two representatives were given \$50,000 in cash to provide assistance in immigration issues and other political favors. Errichetti also introduced the Arab businessmen to Frank Thompson, Jr., a well-established Democratic New Jersey legislator. Thompson was the chairman of the House Committee on Administration and the Subcommittee on Labor-Management Relations.

Similar to Myers and Lederer, Thompson was offered bribes to help the Arabs overcome immigration laws. From this arrangement, Thompson intro-

duced the Arabs to another congressman, John Michael Murphy, from Staten Island, New York. Murphy was chairman of the Committee on the Merchant Marine and Fisheries and readily helped the Arabs in exchange for monetary gifts. Finally, Errichetti introduced the Arab businessmen to Harrison Williams, Jr., the senior senator from New Jersey.

Williams was a distinguished Democratic legislator who served as chairman of the Committee on Labor and Human Resources and of the Subcommittee on Securities, Housing, and Urban Affairs. Beyond cash incentives, Abdul Enterprises offered Williams stock certificates in a fraudulent titanium company in exchange for influencing government contracts for proposed ventures.

The many exchanges between the Arab agents and the congressmen were secretly recorded and videotaped by the FBI. These recordings captured meetings, agreements to accept payments, and the actual acceptance of bribes. Telephone conversations were also recorded. Based on this evidence, several legislators were brought to court on charges of bribery. In many instances, the legislators maintained that the ABSCAM operations were prime examples of entrapment intended to smear them and their reputations. Notwithstanding these allegations, several of the legislators were convicted of various criminal charges and some were even sentenced to prison terms including Senator Harrison Williams.

Beyond the criminal convictions, many members were expelled from Congress or forced to resign. For instance, Michael Meyers was expelled from the House of Representatives marking one of the few times in history a sitting member of Congress was expelled for committing official corruption. Two other members, John Jenrette and Raymond Lederer resigned before their expected expulsions. Williams also resigned just days before his expected expulsion.

SEE ALSO  
bribery; corruption; graft.

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## accounting fraud

ACCOUNTING FRAUD, or false financial reporting, is often at the heart of the most extensive white-collar crimes. Among the examples are the Equity Funding Corporation of America, the fiscal fabrications of hundreds of savings and loan annual reports in the 1980s, and Enron Corporation. Accountants and auditors may assist in other corporate offenses by covering up evidence. For example, by making profit from labor or environmental law violations appear as legitimate income or keeping it off the records altogether.

Accurate financial statements and reports of assets and liabilities, profit or loss, are absolutely required for business and investment decisions. Accounting fraud involves falsification of financial records by overstating profits and assets, understating liabilities and debt, or hiding profit from tax authorities. The complexity of accounting practices makes obscuring a company's true financial standing easy. As such, the public relies on the professional ethics of accountants.

Opinion polls place accountants among the most honest professionals. The designation Certified Public Accountant (CPA) after an accountant's name tends to reassure us her report is a true representation of the financial status of a business or organization. The image is enhanced by independent auditors, whose accounting examinations are often required by law.

With honest accountants and auditors double-checking figures, we assume correctly, in most cases, that financial statements are reliable descriptions of financial positions. Incidents involving Enron, WorldCom, and other corporations engaged in massive accounting fraud caution against such assumptions.

Accountants may overtly falsify or issue highly misleading statements for many reasons. Just because they are audited is no guarantee financial statements are correct, as the Enron and other casew-cases illustrated.

POSICIONES	Cts.	REINTEGR	Pesetas	Cts.
	164		50	1
	148		10	1
	498		12	1
	429		50	1
	138		14	1
	253		14	1
	393		14	1
	141		14	1
	141		14	1

*Accounting fraud can be complex or as simple as changing the left-most digit in a column.*

The role of accountants and auditors in accounting fraud is complex. Accountants do not have control over the data they are given. There is a lot of room for dishonesty, if not by the accountant, then by employers or clients applying pressure or misleading financial data. The potential for fraud is considered in training accounting students, alerting them to the possibility of being asked to certify financial reports that are less than accurate.

The auditor's main job is ensuring standard accepted accounting practices are followed. Even if not, given the complexity of corporate accounts, they can explain "irregularities" that are not fraudulent. Extensive accounting frauds require some cooperation between auditors and executives in a company to falsify and certify incorrect reports. Auditors may not want to question some practices or data submitted by good clients.

The line is crossed when what is clearly fraudulent is termed an "irregularity" by auditors remaining silent in the face of an obvious accounting fraud. Accounting practices can be so far from standard regulations, or in violation of regulations that auditors who remain silent or otherwise cover-up a fraud can be criminally charged. By such inaction they become part of a criminal conspiracy.

Accounting fraud takes many forms. While some are complex requiring advanced knowledge of accounting principles, those most common are easy to understand. To name a few, the oldest is keeping two sets of accounting books. First, there is the set that accurately indicates the company's financial position, and the second set of books is for the Internal Revenue Service, illustrating a much less

profitable enterprise for tax purposes. There are many ways false financial records help executives or other company personnel. If short-term revenues fall short of goals needed to receive a bonus, accountants can be asked to make it appear as if goals were reached. Fraudulent invoices for products and services not delivered make revenues appear higher.

Simple tricks include listing income near the end of a quarter in the revenue column for merchandise not yet shipped; this is revenue that belongs in the next quarter. When it appears sales are going to be low, channel stuffing involves shipping unordered goods to regular customers. If, or more likely when, merchandise is returned, there is a worse problem in the next quarter, but for now these unordered shipments are recorded as sales on the current quarterly report.

At other times, usually for tax purposes, it is desired to report low profits. False expenses make profits seem smaller. To cheat tax authorities, corporations that operate globally can resort to transfer pricing. The corporation divides operations, placing subsidiaries in different countries. One is called a production company and the other distribution. The production company is located in a high-tax country and it sells millions of units to the distribution company at a nominal price. Since the value of products sold is recorded as small, tax is low. The distribution company in a low-tax country greatly increases the unit price for sale. Profits are high, but taxes are low due to its location in a low-tax country.

## OVERT AND COVERT FRAUD

Many accounting frauds are overt falsifications. On the simplest level, changing a number in a column far enough to the left drastically changes the appearance of a company's financial situation in the direction desired by those involved in the fraud. However, most accounting frauds involve a series of transactions to at least make things appear legitimate.

A classic example was in the savings and loan scandal of the 1980s, which engaged in land flips. In a land flip, a piece of real estate is bought for a few thousand dollars and listed as an asset worth millions. A series of transactions took place between two or more savings and loans buying the same piece of land, knowing full well it was not worth much, at an ever-increasing price for each transac-

tion. What was next to worthless was then listed as a major asset.

Motives for accounting fraud and the way records are falsified vary by industry and the goals offenders have in mind. Increasing sales commission suggests one method, while cheating on taxes is another. For the largest schemes, perpetrators have a vested interest in corporate profits. Executives receive stock options and a large number of shares as part of their compensation. If revenues increase, so does their income.

As such, accounting fraud often has its origin among executives. Since executives are hired to increase profits and stock prices the report to shareholders indicates whether or not they have been successful. They do not want bad news for shareholders (nor for themselves) so they put pressure on accountants to make the report look as favorable as possible. Not only executives, but also lower-level managers are paid on the basis of company performance, usually in sales. The W. T. Grant Company went bankrupt in the 1970s because store managers learned how to make sales appear good enough to meet goals to net pay increases and bonuses, when, in fact, sales were low. By the time the true financial picture became clear, it was too late to avert bankruptcy.

Accounting fraud can make just about any bad financial situation appear good. When natural downturns in markets occur, resorting to accounting fraud is usually felt to be temporary. In the long run, it is doomed to fail. When revenue cannot cover expenses and loan payments, failure is inevitable regardless of what an inaccurate financial statement reports.

#### SEE ALSO

Equity Funding scandal; Enron Corporation; stock fraud; insider trading; land flips.

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## Adelphia Communications

CREATED AND FOUNDED by John J. Rigas, Adelphia Communications grew in the 1990s to become one of the largest cable media providers in the United States. Because of its size, investors and shareholders were shocked when they learned that the company filed for bankruptcy in June 2002. However, headquartered in Coudersport, Pennsylvania, a small rural community that Rigas called home, Adelphia Communications was not immune from white-collar crime. Federal investigators arrested Rigas, and his two sons, Michael and Timothy, on July 24, 2002, and paraded the group in handcuffs before the media.

At 77 years old, Rigas did not appear to be a typical criminal. The accusations levied against him, his sons, and two other employees, were far from typical. The group was accused of concealing \$2.3 billion in debt from investigators and shareholders, and hiding their deals that were motivated purely out of self-interest rather than corporate interest. Estimates suggest that their illicit actions netted them \$1 billion which they used to support their lavish lifestyles. According to federal prosecutors, the defendants misused the money as personal loans and cash advances, and even built a \$13 million professional golf course with the misappropriated funds.

Rigas, his sons, and the two employees involved in the scheme, former Vice President of Finance James R. Brown and former Director of Internal Reporting Michael C. Mulcahey, were indicted in October 2002. United States Attorney James B. Comey described the scheme as "one of the most elaborate and extensive corporate frauds in United States history." They also faced stiff civil charges for their misdeeds.

If convicted of the criminal charges, each defendant could be sentenced to up to 250 years in prison, fines up to \$20 million, and forfeiture of



\$2.5 billion. To some observers, Rigas was used as the poster boy of what the government can do to white-collar offenders. To others, the system's response was long overdue. Many of those who live in the Coudersport community continue to stand behind Rigas, offering their support and questioning the veracity of the charges against him and his sons.

#### SEE ALSO

securities fraud; bank fraud; corporate liability.

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## advance fee fraud

A SPECIFIC TYPE of fraud that has become synonymous with African-based criminal groups, and Nigerian criminal enterprises in particular, is popularly referred to as advance fee fraud (also called "419 Fraud" after the relevant section of the Nigerian Criminal Code). This fraud scheme emerged in the early 1980s and is a variation of the confidence swindle, which preys on peoples' greed and naively. Advance fee fraud targets individuals and businesses offering huge sums of money from government officials or businessmen in African countries. The targets of the fraud—which include businesses and individuals—receive a solicitation (by letter, fax, and increasingly e-mail) from a businessman or ex-government official in an African country, promising that a large sum of money (often in the tens of millions of dollars) will be deposited into the target's bank account. In return, the recipient of the letter is offered a percentage of the total amount that purportedly will be wired or transferred from Nigeria (or another African country).

The solicitation will ask its prospective victim to respond to the correspondence, including name, address, phone number, and banking information. Subsequent correspondence will ask for a process-

ing fee from the target before the money can be transferred. This fee is often in the tens of thousands of dollars. The letter will often provide specific directions on how this fee should be paid (usually a wire transfer to an overseas bank account). Once the processing fee is deposited, the funds are quickly withdrawn, and the perpetrators either disappear or attempt to coax even more money from the victim. Some schemes have gone so far as to have victims fly to an African country, where they are extorted for even more money through intimidation and violence. Of course, no funds ever transferred to the target.

The funds that are purportedly to be deposited in a target's account are frequently described as money that must be quickly and surreptitiously transferred out of an African country due to a number of reasons, such as a civil war, bankruptcy fraud, an unclaimed bank account or inheritance, or the embezzlement of money from a government or business. Regardless of the specific claim, the source of the funds is frequently held out as illegally derived. This tactic is used to increase the credibility of the offer (relying on widely held awareness of corruption in African countries) and to deter any victims who accept the offer from going to police due to their own perceived complicity in an illegal action. Although originated by Nigerian criminal groups, advance fee fraud scams now originate in a number of African countries and use internal conflicts or other circumstances specific to that country as a pretense under which funds must be transferred abroad. Below is just one example of hundreds of thousands of advance fee fraud letters (in this case, via spam e-mail).

Dear Friend,

Compliment of the season to you. I contact you with the uttermost trust and full hope that you will be in position to assist me in this mutual transaction that will benefit both of us if we join hands to work as partner. And a choice of your Country.

I am James Biko, 24 yrs old, from Guinea Bissau, born and brought up in Ghana. The son of late chief Martins Biko a gold merchant and dealer in Ghana. I must confess my agitation and my word is my bond.

Late chief Martins Biko, who was assassinated on 17th Aug 2001 by unknown faces on his way to Accra Ghana, may his soul rest in

peace. Before his death, he made a deposit of two trunk boxes contents US\$14.000.000 million and (286) kilos of (Raw Gold), with a reputable Security Company here in Cote d'Ivoire. And registered the contents as Family valuables belonging to his foreign business partner who will come soon for the claim/release and export to Abroad (no name).

I ask for you to focus your mind in this transaction, for this is not Government money, this transaction is Legal, Genuine and no risk of any kind in this transaction.

I humbly request for your permit, to submit your name to the security company as my late father's foreign business partner, for the immediate change of ownership with your name as the beneficiary of the consignment for onward release of the two trunk boxes said (money/Gold). And also, you help me to market the (Gold) and invest the money in a blue chip and profitable business in your Country, you been the trustee. While I will continue my Education.

As soon as you find this possible and interesting to help me, kindly furnish me with the followings: (1) your full name and contact address. (2) your private Tel/Fax numbers. All this information, I will submit to the security company for the change of ownership with your name and to enable me send to you the following documents proof via your Fax number: (1) The deposit certificate (2) Agreement and the receipt of the of-front payment, paid by my late father. (3) The Will proof, Legally and willed by my late father for this transaction.

Please, don't betray me if this money comes to your care, because this money is my only future hope, and be rest assured that this is real and never a joke.

I offer to give you (25 percent) of the total sum after the release of the boxes for your noble assistance. Treat as confidential for the security of this transaction and my Dear Life. Waiting for your urgent and positive response.

Best regards,

James Biko  
Abidjan, Cote d'Ivoire

SEE ALSO  
Nigerian 419; scams; internet fraud.

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## advertising fraud

ADVERTISING FRAUD is generally defined as advertising that is misleading in any material respect, either explicitly or indirectly through representations made in a statement or combination of statements, and any failure to reveal material facts. A statement or representation in an advertisement may also be false or fraudulent when it constitutes a half-truth.

The legal definition is much stricter than common sense, which requires the element of "deception" in advertising to establish the illegality. According to Section 15 of the Federal Trade Commission Act of the United States, deceptive advertisements are those that are "misleading in material respect," and this has been interpreted by the courts to mean that the deceptive advertisement must affect the purchasing decisions of the customer.

Any form of commercial information or communication, which is contrary in whole or in part to actual conditions or to the acquisition conditions of the goods and services offered, or using texts, dialogues, sounds, images, or descriptions that directly or indirectly, or even by omission of essential product information, can mislead, deceive, or confuse the consumer. All forms of fraudulent advertising or abusive advertising are prohibited, as are those leading to error in the choice of the goods or services that could affect the interests and rights of the consumer.

Many economists complain that the extensive and fraudulent use of advertising involves undue costs and is a bar to free competition, with a result-

ant adverse effect on the operation of the free price system. Experts in home economics charge it with being a poor guide to consumption. Criminologists and legal scholars have noted its far more serious consequences, including death and bodily harm caused by fraudulent advertising.

On the other hand, according to the "high standard of living" hypothesis, advertising represents an economical means of exchange. It could help to lower costs because it makes possible large-scale operations in industries operating under decreasing costs. It is an essential source of product information in an advanced economy. It could actually encourage product development and technological improvement by inducing consumers to want the new and improved products offered.

Therefore, it is implied that advertising fraud could be forgiven in order to promote a high standard of living for the society as a whole. However, the argument that advertising fraud could be tolerated has lacked resources for obtaining the needed evidence based on a large-scale analysis of such a problem. Some scholars argue that advertising expenditures are wasteful by creating a demand to use up natural resources and increases the cost of products.

The history of corporations using blatantly fraudulent claims, as well as exaggerated claims, or puffery, is a long one. The roots of the tremendous growth in American advertising that took place after the Civil War were laid down over centuries of evolution in Western market places.

Ethical issues regarding advertising were seldom raised because advertising was considered merely a matter of announcing the availability of products. Even then, however, manufacturers devised and implemented skillful and boastful advertising to sell harmful drugs and other bad products. By the end of the 19th century, abuses in advertising flourished along with consumers' suspicions about advertised food. Pure food regulation, not advertising regulation, was introduced to deal with such a problem in the second half of the 19th century.

In the United States, heightened attention to advertising's credibility in the first decade of the 20th century foreshadowed the appearance around 1911 of an energetic truth-in-advertising movement, which initiated legislation and established organizations to combat dishonest business advertising. However, the criminal nature of the sanction, the inclusion of requirements of intent, materiality,

and other restrictive elements, and the failure to provide administrative machinery for enforcement, severely limited the effectiveness of these statutes in suppressing false or misleading advertising. More generally, the advertising industry's desire for self-regulation has meant that prosecutions have been infrequent and convictions rarer still. Private negotiation resolved most complaints.

## REGULATION

Federal and state laws and the Federal Trade Commission (FTC) accompanied this self-regulation. In 1914, the Federal Trade Commission Act was enacted, which states that false advertising is a form of unfair and deceptive commerce. Under the act, the term false advertising extends well beyond untrue advertisements. It also includes advertisements that make representations that the advertiser has no reasonable basis to believe, even if the representations turn out to be true. An example would be an advertisement for a vehicle that states that the vehicle uses less gasoline than any comparable vehicle. The advertiser would have committed false advertising if it had no reasonable basis to believe the truth of this claim (such as through comparative tests), even if it turned out to be true.

Under the law, the government doesn't have to prove the deceptive intentions at an administrative hearing or in court. The fact that it had a deceptive quality is sufficient. If the ad is deceptive in nature, the defendant faces legal problems even if she has the best intentions. The fact that she didn't know the information was false is irrelevant. To determining whether or not a statement is deceptive, however, is a much more complex process, because one must not only examine the nature of the statement but also the potential effect on the customer.

The FTC Act created the FTC and gave the commission broad authority to regulate advertising. The FTC is the main federal agency that takes action against unlawful advertising. Under this broad mandate, the FTC has issued regulations prohibiting advertisements that could be misleading even if they are true. A famous example involves Anacin, a brand of aspirin. The maker of Anacin ran ads claiming that clinical tests showed that Anacin delivered the same headache relief as the leading pain-relief prescription. The ad did not mention that aspirin itself is the leading pain medicine. The FTC determined that the ad was misleading. The ad im-

plied that Anacin was more effective than aspirin, when in fact, Anacin is really just aspirin.

Over the years, the FTC has taken enforcement actions against many businesses accused of engaging in false and deceptive advertising. A significant number of those administrative actions have been tested in court. For the most part, the FTC relies on consumers and competitors to report unlawful advertising. If FTC investigators are convinced that an ad violates the law, they usually try to bring the violator into voluntary compliance through informal means. If that does not work, the FTC can issue a cease-and-desist order and bring a civil lawsuit on behalf of people who have been harmed.

The FTC can also seek an injunctive decree from the court to stop a questionable ad while an investigation is in progress. In addition, the FTC can require an advertiser to correct ads, that is, to state the correct facts and admit that an earlier ad was deceptive. For example, Listerine mouthwash was long touted as a cold and sore throat remedy. The FTC forced the manufacturer to run ads stating that Listerine would not cure colds or relieve sore throats.

The FTC has a further power, known as “fencing in.” This enables the FTC to bar misleading ads with respect to a particular product and across all of a business’s other unrelated product lines. For example, a testimonial constituting false advertising regarding product A could lead purchasers to believe that products B and C must also be great. In that case, the FTC could bar use of the ad for products A, B, and C.

Court decisions indicated that the judiciary would look favorably on commission action against dishonest advertising. By 1925, advertising cases accounted for three-quarters of the FTC’s orders. In the 1920s and 1930s, a consumer movement attacked deceptive advertising. The efforts of the consumer groups generally reinforced earlier notions that truthful information was at the heart of consumers’ needs. Consumer advocates in the interwar years showed little faith that advertising itself, even if regulated, could supply the truthful information that buyers required. Within the advertising industry, however, there were modest moves toward self-regulation, in part to stave off burdensome external controls, in part to curb what advertising people themselves considered to be persistent abuses. The American Association of Advertising Agencies, for example, devised a code of ethics for its members in

1924, but it was vague and lacked the threat of punishment.

## TELEVISION AND CONSUMERISM

Despite the clarification of its authority to take action against deceptive advertising, the FTC in these years was hamstrung by bureaucratic inertia and a cumbersome legal process. A business journalist in 1957 described the FTC as “a headless, drifting agency which acted desultorily and seldom hurt anybody very much.” The postwar years, however, saw both changes in the nature of advertising and the appearance of new critiques of advertising and consumption. Advertising volume expanded along with the booming economy, but perhaps more crucially, it employed the new medium of television to reach its audiences.

By 1960, advertisers spent over \$1.5 billion on television. The new medium’s fusion of sight, sound, and motion in living rooms forced an expansion of the concept of truth in advertising. In 1970, for example, the FTC took action against Campbell Soup for a commercial for vegetable soup, in which the photographers had put clear marbles at the bottom of a bowl to make the soup’s ingredients rise to the top and appear more abundant. Campbell agreed in a consent order to discontinue the procedure.

These changes set the stage for a revival of consumerism and new efforts to control advertising during the 1960s. Consumerists had long complained that the FTC and other regulatory agencies shared a revolving door with regulated businesses. Although self-regulation and government control had recognized some of the new problems, the major challenge to policy makers was to find appropriate ways to curtail the fraudulent abuses in advertising.

Awakened from its postwar torpor by some sharp consumerist attacks, the FTC emerged by the early 1970s as a more energetic regulator of advertising practices. The FTC had broadened the definition of advertising fraud from the Progressive Era’s fixation on literal truth. It began a program requiring advertisers to provide information substantiating the claims they made in their publicity.

Failure to supply adequate evidence, in the judgment of commission staff, could bring about a charge of deception or unfairness. Indeed, the FTC articulated a principle stating that advertising claims

that lacked a “reasonable basis” for belief were unfair practices.

It was, however, nowhere near the solution to the problem because the FTC had not been given the legal instruments or the staff necessary to effectively administer and monitor advertising. Moreover, in many cases, the FTC relied heavily upon making deals with companies, in the form of consent orders, to halt misleading or false advertising. In 1971, consultation among advertisers, agency, and media interests bore fruit in the creation of a new self-regulatory system. The scheme designated the National Advertising Division (NAD) of the Council of Better Business Bureaus as an investigating body and created a National Advertising Review Board (NARB) to evaluate complaints about advertising.

The purpose or mission of the NARB, as explained in its Statement of Organization and Procedures, is to “sustain high standards of truth and

accuracy in national advertising.” In reviewing advertisements, if a panel of the NARB decides that an advertisement is misleading or deceptive, it will request that the advertiser modify or withdraw the ad. If the advertiser “fails to respond or indicates his unwillingness to accept or comply with the decision, the panel will issue a Notice of Intent to the advertiser that the matter will be publicly referred to an appropriate agency of government.” The NARB therefore serves as a self-regulatory agency, monitoring the activities of companies and agencies alike.

### ADVERTISING GROWTH

At the same time, advertising has expanded rapidly since the 1970s. In 1973, advertising expenditures amounted to \$25 billion, and by 1993 had increased to over \$110 billion in the United States. Since the mid-1970s, however, pressure for deregulation has partially stymied governmental and industry efforts to regulate advertising. The FTC has been attentive to business protests against its actions and hostile to governmental regulation against false advertising. The FTC was reluctant to pursue deceptive and unfair advertising cases during the Ronald Reagan years in the 1980s. Chairman James Miller of the FTC in the Reagan administration, for example, asked Congress to enact a restrictive definition of deceptive advertising. When Congress rejected this path, a majority of the commissioners voted to apply it anyway in FTC work. These standards required a showing of “likeliness to mislead” the “reasonable” consumer about “material” matters rather than incidental ones.

On the other hand, consumers became impatient with misleading and deceptive advertising, tired of being treated like pawns in a market grid box, and of being intellectually abused by a bombardment of inane and degrading advertisements. In almost every piece of merchandise a consumer buys, she is influenced consciously or unconsciously, directly or indirectly, by advertising. Some scholars declared that all advertising is deceptive because it is designed to manipulate. The major part of informative advertising is, and always has been, a campaign of exaggeration, half-truths, intended ambiguities, direct lies, and general deceptions. In a Gallup poll on the honesty and ethics of people in 32 different professions, advertising and advertising practitioners ranked near the bottom. False nutri-



*Used-car dealers have been known to employ deceptive advertising in luring customers to car lots.*

tional claims and falsified demonstrations are just two illegal aspects of advertising and product promotion, which is a \$100 billion a year business in the United States.

## LANHAM ACT AND STATE LAWS

In addition to the FTC under the FTC Act, private parties, such as consumers or competitors, can also bring a legal action regarding false advertising under the Lanham Act. To establish a violation under the Lanham Act, consumers and competitors must prove the following: 1) the advertiser made false statements of fact about its product; 2) the false advertisements actually deceived or had the capacity to deceive a substantial segment of the target population; 3) the deception was material; 4) the falsely advertised product was sold in interstate commerce; and 5) the party bringing the lawsuit (the plaintiff) was injured as a result of the deception.

Actual loss is not required to show an injury. All that is needed is a reasonable basis for the belief that the plaintiff is likely to be damaged as a result of the advertising in question. An example of such damage would include ads that deceive consumers who are the target population of both the advertiser and the plaintiff. The penalties for a Lanham Act violation include the plaintiff's lost profits, the additional profits to the advertiser resulting from the deceptive ad, treble damages, and attorneys' fees.

In addition to the FTC Act and the Lanham Act, which are federal statutes, most states also have laws proscribing false advertising. For example, Illinois has enacted the Uniform Deceptive Trade Practices Act. Under the act, a "deceptive trade practice" includes such practices as "palming off," misrepresentation, product disparagement, and bait-and-switch advertising.

Palming off occurs when an advertiser creates the impression that its goods or services are those that are furnished by a competitor. For example, this could occur if you set up a hamburger stand that looked like a McDonald's restaurant. Misrepresentation occurs when an advertiser makes false or misleading claims about its goods or services, as under the FTC Act and the Lanham Act. Product disparagement occurs when an advertiser intentionally makes false or misleading negative remarks about competing goods or services, causing its competitor to lose sales. Bait-and-switch advertising occurs when the advertised goods or services are

withdrawn from the market and substitute goods or services are instead offered for sale.

Most states have laws, usually in the form of consumer fraud or deceptive practices statutes that regulate advertising. Under these laws, state or local officials can seek injunctions against unlawful ads and take legal action to get restitution to consumers. Some laws provide for criminal penalties, such as fines and jail, but criminal proceedings for false advertising are rare unless fraud is involved.

Consumers often have the right to sue advertisers under state consumer protection laws. For example, someone who purchases a product or service in reliance on a false or deceptive ad might sue in small claims court for a refund or join with others to sue for a huge sum in another court.

A competitor harmed by unlawful advertising, or faced with the likelihood of such harm, generally has the right to seek an injunction and possibly an award of money (damages) as well, although damages are often difficult to prove. Such cases usually are based on one of two legal theories: unfair competition or commercial disparagement. Despite these different laws which deal with advertising fraud, the most powerful tool is still the FTC Act in the United States. Some scholars noted that prosecutions of false advertising cases had proven difficult under the fraud laws due to the absence of major, highly motivated victims and problems of proving intent and damage. Some argue that the FTC action against advertising fraud can be improved if the government facilitates the agency with more staff and resources, as well as political support.

In fact, the difficulty of proof and the trend of lenience toward advertising fraud cases can be found in many countries in the world. For example, in Canada, each year thousands of allegedly false, misleading or deceptive advertisements are reported to the Department of Consumer and Corporate Affairs.

The number of files of advertising illegalities opened went from 33 in 1968–69 to 12,374 in 1987–88. However, only a small number of the cases resulted in recommendations to the attorney general for criminal prosecution. There have been very few convictions against advertising fraud.

## SEE ALSO

Federal Trade Commission Act; Federal Trade Commission; reform and regulation; prosecution; puffery.

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## Africa

AS ONE OF THE last parts of the world to strive for an advanced capitalist economy, Africa was also one of the last to develop a significant international business elite. Until the wave of decolonization following World War II, the countries of Africa were more often the victims of corporate and government malfeasance, and mismanagement by countries outside of the continent. Only recently have these countries, especially South Africa, faced the challenge of holding the reins on economic crimes in times of political transition and economic globalization.

White-collar crime is a Western concept and is not always easy to apply to the various societies of Africa, whose ideas of both crime and economics can be radically different. For example, western African customs long supported the dash system, in which government officials performed their duties in return for tips, or dash. When Western corporations sought to do business in countries such as Nigeria, it was expected that they would also participate in the system and provide dash in order to grease the gears of business. The local elites saw this as tradition not as bribery, but through Western eyes it fits the definition of white-collar crime.

West Africa became firmly linked to the nascent global economy in the late 16th and early 17th centuries with the advent of the Atlantic slave trade.

The trade originated with the Portuguese, who sent government-backed missions to Africa to procure gold for trade with Asia. Once the other Europeans learned of the market for slaves, competition increased and a number of joint-stock companies, notably the Dutch West India Company (WIC), based their existence on the profits from the triangular trade between Africa, Europe, and the Americas.

## THE CORPORATE SLAVE TRADE

Initially, these companies were not strictly-speaking exploitive, as they tapped into already existing networks for procuring and selling slaves, but their involvement increased the intensity of the trade and contributed to profound political changes. Along the west coast of Africa, leaders used the profits and prestige of the Atlantic slave trade to consolidate their power over tribe members and to extend that power over others. The trade created and strengthened an economic and political elite who often leveraged their positions for personal gain, a trend that would continue in the 20th century.

The large profits from the slave trade also encouraged economic recklessness back in Europe. In the 18th century, two spectacular stock market bubbles, the Mississippi Scheme in France and the South Seas Scandal in England, stemmed from the creation of joint-stock companies whose profits were to come from the slave trade. John Law's Mississippi Company failed spectacularly, leaving France with massive debt, a general mistrust of financial instruments, and lingering concerns about the government's ability to manage its finances. The fallout from the scandals had little effect back in Africa because competition for lucrative and exclusive slave-trading contracts was intense, and when one player dropped out or proved unsatisfactory, there were always others waiting in the wings.

Slavery was outlawed by nearly every Western country by the 19th century and many expected that Africa would follow suit. When this proved not to be the case, imperial powers cited the continuation of slavery as a moral pretext for greater control by paternalistic, economically advanced countries. In the late 19th century, nearly all of Africa was carved up by European powers into spheres of colonial rule. The cooperation of African leaders was assured through the financial and political incentives, often thinly disguised bribery. The primary purpose of these colonies,

however, was economic. Europeans were looking for new markets for their own manufactured goods and new sources of key raw materials, such as copper or oil.

## CRIMES OF IMPERIALISM

Whether or not new imperialism could be called a crime is a hotly debated subject. Defenders of the idea point to the essentially exploitative nature of colonial interests. Imperial powers would extract valuable raw materials from their dependencies, but for use and profit of the home country only. The enterprises would provide little extra employment for the natives and even less tax revenue. Once they became independent, the countries of Africa would find themselves “looted” of their most valuable resource and with very little capital to show for it. Colonialism also heightened the previously existing distance between the economic elites and the rest of the population. More than ever, economic power came with collusion with the West.

When the colonial powers became distracted by the triple catastrophes of World War I, the Great Depression, and World War II, African countries gained increasing degrees of independence and by the 1960s, most were at least nominally independent of their former masters. In addition, the global economic boom that followed World War II resulted in rapid economic growth for most of Africa. This combination of new governments and economic change proved to be very volatile. With little experience in managing export-oriented industries, many new leaders found themselves relying more on customary relations than development theory. Warring tribes struggled for political and economic control and national loyalties were often weak or nonexistent. Political corruption ran rampant, especially in sub-Saharan regions, and was called “the most destructive of Africa’s moral diseases.”

## NIGERIA

Nigeria provides an interesting case study. It became independent in 1960, but almost immediately violent rebellions erupted among the different tribes, each demanding their own state. The country was divided into 12 states (later 19), resulting in an unstable federation. Government officials remained loyal to their own tribes. After a rigged election in 1966, civil war ensued, to be replaced by military

government. Nigeria was fortunate to have large oil reserves and the sale of oil constituted the bulk of Nigerian government revenue by 1979. With renewed confidence from the civil war and military rule, several Nigerian officials began awarding contracts to foreign corporations in return for substantial kickbacks. According to analysts, “most Nigerians believe[d] that their government ministers, civil and military, systematically take a rake-off on government contracts.” Some scholars have contended that at different times the Nigerian government used its position essentially to collect bribes, resulting in major transfers to personal accounts in foreign countries.

## GHANA, UGANDA, ZAMBIA

Different countries dealt with the rampant corruption in various ways. Military or one-party dictatorship was one option. In Ghana, Colonel Ignatius Kutu Acheampong seized power in 1972 after civilian government proved unable to deal with widespread political corruption, especially smuggling by officials. His regime showed that military regimes were no better equipped to handle the problem than nonmilitary governments and he was quickly deposed.

In Uganda, Idi Amin, a former general, took over power in 1971. Amin had been accused of large-scale smuggling and misappropriation of funds while serving previous governments, though he used his influence to exonerate himself. He then used the money gained from these activities to increase his personal control over the army, making his coup possible. He quelled ethnic conflicts in the country by eradicating members of rival tribes, the Acholi and the Lango, and by forcibly expelling Uganda’s economically dominant Asian minority.

In Zambia, President Kenneth Kaunda dealt with corruption from a Christian-inspired moral perspective (his father had been a minister). For example, he fired his minister of labor for being involved with a company that had received many questionable loans from the government. In a celebrated case in 1970, he suspended numerous others for misuse of government revenue. His one-party state, however, did not enjoy widespread support.

Many countries dealt with corruption by instituting greater state control over the economy, sometimes with socialist overtones. War-time conditions had greatly increased the power of the state to regu-



late the economy. African leaders often expanded this power to include marketing boards, government ownership of industry, and increased exchange and price controls. In North Africa, the creation of the OPEC (Organization of Petroleum Exporting Countries) cartel in 1960, as a means of leveraging the oil resources of nations such as Libya, Algeria, and Nigeria, was a significant contribution to corruption. These policies favored the dominance of an economic elite and often had deleterious effects on small producers, especially in agriculture. They also created the opportunity for further political corruption in the form of selling government contracts, licenses, monopolies, or other inside deals in return for cash payments.

Beginning in the 1980s, problems with debt and exchange rates forced many African countries to adopt stricter policy controls from international institutions, notably the IMF (International Monetary Fund) and the World Bank. Along with these changes, political reform and democratization have also advanced. Many of Africa's more notorious dictators, such as Uganda's Amin, have been overthrown, resulting in more open government.

## REFORM AND CORRUPTION

New and reformed regimes have also had problems with corruption. In July 2002, for example, President Ange-Felix Patasse of the Central African Republic had 20 government officials arrested for embezzlement. In Malawi, the IMF has accused the president of illegally selling grain reserves shortly before a major drought, and in Angola rampant corruption has frustrated the efforts of humanitarian workers to restore services after the civil war.

In the later 20th century and early 21st, corruption and white-collar crime have become less internal to the government systems and increasingly linked to relationships with multinational corporations. In 2003, the president of Nigeria accused several multinational oil companies of taking some \$600 billion in illegal tax bonuses. In 1992, the Khalifa family, based in Algeria, began taking advantage of new open markets to create a worldwide empire, including the first private Algerian bank, an airline, two television channels, and companies specializing in catering, rental cars, graphic design, and construction. Economists reckoned the collective worth of the group to be close to \$2 billion annually. In 2001, the group came under government sus-

picion and transfers were suspended. While leaving the country, three bank managers were apprehended with large suitcases full of cash. Since then, the Algerian government has suspended the operations of most of the other branches of the group, laying off thousands, and the leader, Ralik Khalifa, has gone into hiding.

## SOUTH AFRICA

In South Africa, the transition from apartheid to the rule of the African National Congress (ANC) coalition has been difficult and all types of crime, including white collar, have been on the rise. In one of the most publicized cases of such crime, Winnie Mandela, former wife of ANC founder Nelson Mandela, faced 85 charges of fraud and theft in 2002. Using her control over the ANC's Woman's League, Mandela helped to forge letters with the purpose of getting bank loans for the organization.

Convicted of most of the charges, she was sentenced to five years in jail. Despite the existence of numerous organizations designed to fight white-collar crime, corporate and government scandals have also proliferated. In 2001, a project to modernize the South African armed forces resulted in the distribution of numerous lucrative contracts and allegations of significant kickbacks and favoritism among government ministers. Similar accusations were made regarding the purchase of HIV/AIDS



*Cape Town exemplifies the post-apartheid South African economy fraught with its share of corruption.*

drugs. The credibility of government officials was also tarnished by a scandal over diamond and land rights involving the New Diamond Corporation and the acceptance of bribes from Taiwanese officials designed to block South African recognition of mainland China.

On the other hand, the government has accused South African chemical company SASOL of conspiracy and dishonest practices in connection to its cooperation with German banks. In 2002, the principle managers of South Africa's second largest trade union, Nehawu, faced charges of theft and fraud when a government audit found over 500,000 rand missing from its accounts.

#### ADVANCE FEE FRAUD

Perhaps the most infamous white-collar crime to come out of Africa in recent times is the Nigerian Mail scam. Using an official-looking structure and language, the e-mails suggest to the unwary that they help a Nigerian official to recover funds by providing bank account information. In return for the users' cooperation, they will get a percentage of the recovered funds, often millions of dollars. Fraudsters, working largely at internet cafes in Nigeria and other African countries, have sent millions of these e-mails. Many have been successful, though the exact amount of funds unwary volunteers have forfeited remains unknown. The scam has attracted a host of imitators in other African countries.

#### SEE ALSO

oil crimes; corruption; public corruption; bribery; embezzlement; globalization; capitalism; advance fee fraud; South Africa.

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## age discrimination

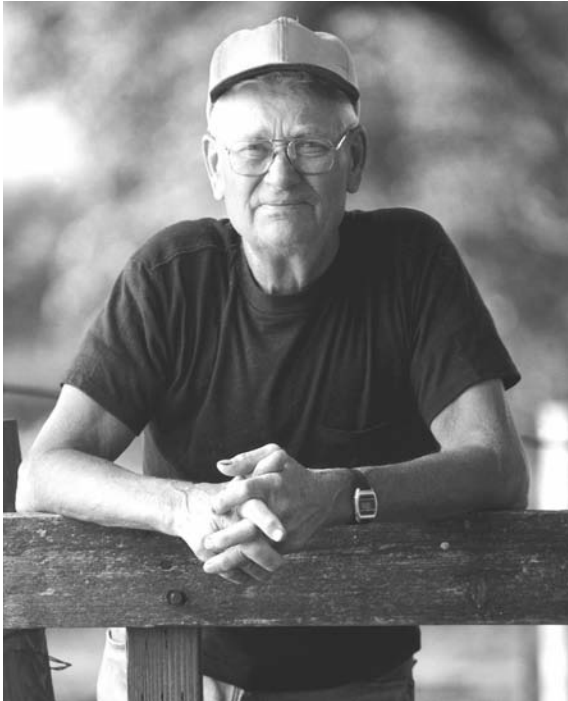
IN THE UNITED STATES, age discrimination is generally associated with old age, but there is discrimination against youth as well. Ageism really was not evident in America until industrialization began, shortly after the Civil War. It reached its zenith when a 1907 veterans law declared that all people over age 62, regardless of their actual state of health, were disabled.

The second cause of age discrimination against the elderly was the Social Security Act of 1935. Ironically, the law was designed to help older people enjoy their "golden years" by providing them with a guaranteed, although meager, pension. Unfortunately the law had the effect of forcing many older Americans out of the labor force after age 65, a practice not made illegal until 1967 with the passage of the Federal Age Discrimination Act.

American society possesses a phobia about aging and being elderly. One reason for the aging phobia concerns the way the mass media obsesses over youth and virtually ignores the elderly or portrays them in a negative light. Numerous studies demonstrate that the elderly are virtually invisible in much of the media.

#### ELDERLY MYTHS

Because their lifestyles and social problems are ignored, mythical stereotypes about their physical, mental, and moral conditions abound: The elderly are senile, mentally ill, or suffer from declining intelligence; the aged are lonely and unhappy to the point of being miserable; the elderly are chronically sick; the aged are unable to live by themselves; the elderly become ill upon retirement; most of the aged are poor; older people are asexual and uninterested in sex; most of the elderly live in nursing homes; the aged are unproductive and a drain on society. These are all myths.



*Age discrimination is mostly based on myths about old age that ignore the vitality of many senior Americans.*

## OLDER AMERICANS ACT

One major attempt to resolve some of the elderly's social problems is the Older Americans Act (OAA, last amended in 2000). This federal law provides the funding and policies for state and area agencies on aging to identify the elderly's needs and provide services that meet those needs. Community providers furnish delivered meals, transportation, information and assistance, outreach, legal assistance, ombudsman services and many others under the act. It does not set specific funding authorization levels, but requests Congress to approve "such sums as may be necessary." The exceptions to this are the family caregiver support component, programs for Native Americans, and older workers funding all set at specified levels. However, funding authorization does not mean actual appropriation. The OAA has historically been funded far below authorization levels.

Other functions of the act include emphasizing the importance of information and assistance services. It creates a hotline for the dissemination of information about retirement, and requires area

agencies on aging (AAAs) to report annually to the state agency regarding needs of older persons and service provision. AAAs must coordinate community-based and long-term care services to enable older individuals to remain in their homes. AAAs must also provide a grievance procedure for older individuals who are dissatisfied with their services.

The act also contains a Senior Community Service Employment Program (SCSEP) to develop individual economic self-sufficiency for seniors through community service activities for unemployed, low-income persons who are 55 years of age and older and have poor employment prospects.

## EMPLOYMENT DISCRIMINATION

A federal law passed in the 1960s prohibits discrimination against the elderly in the job arena. Another paradox of ageism in America, however, is that the number of job discrimination suits filed by elderly persons has reached an all time high. Age discrimination is a particular problem for blue-collar workers employed in declining industries, such as automobiles and aerospace.

Since 1990, cases of forced retirement and outright firing have been filed on behalf of older workers in a broad variety of fields, such as real estate, television news broadcasting, and investment. The bitter truth is that older workers are frequently at the top of the pay structure within most companies, and forcing them out, while retaining younger, less costly workers, is a deviously rational economic act in an age of restructuring and down-sizing.

The elderly suffer very high rates of victimization from white-collar crimes, especially scams (confidence games) and frauds. Amazingly, nine out of 10 fraud victims do not report crimes against them to the police, largely due to personal embarrassment or the smallness of the particular, individual loss. The abuse of elderly people in America is a recently discovered and serious social problem that includes several forms of maltreatment. Physical abuse can include everything from pushing and shoving to rape and assault. Psychological abuse consists of threats, verbal intimidation, and isolation. Many elderly also suffer from neglect, deprivation, inadequate medical care, poor nutrition, and other essential goods and services. The elderly are also prone to financial exploitation, wherein their money is mismanaged, misused, squandered, or stolen.

Finally, there are serious problematic conditions in America's nursing home system. While there are many fine nursing residence units in the United States, a minority of these institutions have been involved in scandals that have caused the public to distrust all nursing homes. Additionally, tens of thousands of deaths in nursing homes occur each year do to the side effects of prescribed drugs. In some cases these are improperly administered.

## YOUTH DISCRIMINATION

Though not within the strict parameters of white-collar crime, age discrimination against youths echoes criminal discrimination against the elderly. Within families, children are the least powerful and most unprotected members. About one in every six children in America is a victim of incest, physical and/or psychological abuse. One-third of the victims of physical abuse in the United States are babies, and at least 5,000 children die from child abuse each year.

Children face abuse not only from inside the family but outside as well. The most recent notorious examples concern sexual abuse by Catholic clergy and daycare center personnel. For example, between 1984 and 2002, the American branch of the Roman Catholic Church paid \$1 billion in settlements of child molestation incidents involving priests.

Over three million American children (one in six under age seven) have dangerous levels of lead in their bodies from paint chips and dust. Each year, gunshots, drownings, and bicycle and motorcycle injuries kill 8,000 American children and permanently disable 50,000. Each year, an estimated 1.3 million children leave home. A growing number (around 10 percent) are "push outs" who leave because their parents refuse to let them live at home, but most leave without parental permission. At least 50 percent of homeless children were physically or sexually abused before leaving home, and push out runaways report more violence and conflict with parents.

Nothing quite attests to the alienation of America's youth as the unemployment rate among teens, versus that of adults. In 2003, unemployment rates were just over 6 percent for adults 20 and over, just one-third of the teen unemployment rate. Poor teens suffer unemployment rates averaging just over 30 percent, compared to rates of 11.2 percent for

poor adult males and 10.5 percent for poor adult females.

## SEE ALSO

gender discrimination; scams; Medicare and Medicaid fraud.

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## Agnew, Spiro T. (1918–1996)

ON OCTOBER 10, 1973, Spiro "Ted" Agnew became the first vice president of the United States to resign because of scandal. Agnew's resignation had nothing to do with the Watergate scandal that had been brewing in the nation's capital since the discovery of the break-in at Democratic party headquarters on June 17, 1972, and was followed less than a year later by the resignation of President Richard Nixon. If Agnew had been more honest, he would have become the 38th president of the United States. Instead, Gerald Ford, who had been nominated by Nixon as Agnew's replacement, succeeded to the office of president when Nixon resigned on August 9, 1974.

The troubles that led to Agnew's resignation could be traced back to his home state of Maryland. State attorneys in Baltimore maintained that Agnew had taken bribes for government contracts, first as a Baltimore county executive and then as governor of Maryland. Agnew responded that the accusations were all "a pack of lies," and insisted that he had become accustomed to "unsubstantiated charges, rumors, innuendos, and speculation" since he had entered political life.

In the early days of the investigation, Agnew never allowed himself to believe that the Nixon White House would not be able to protect him from federal investigators and federal courts. He insisted until his death that he had done nothing

wrong because accepting money for political reasons was “just the way things were done in Maryland.”

Agnew had developed an antagonistic relationship with the media, and they were only too ready to turn the attack on him when reports began to surface that he was under investigation for possible conspiracy, extortion, bribery, and tax evasion. Once he understood that the investigation would proceed, Agnew considered asking the House of Representatives to draw up charges of impeachment. He believed that once he was impeached and on trial before the Senate, public opinion would be on his side. Initially, Nixon was opposed to the idea but later seriously considered it.

However, Agnew’s team of lawyers contended that he should seriously consider a plea bargain to bring the scandal to a speedy and dignified end. The prosecutors agreed, and the bargaining process began on September 13, 1973. Even though Agnew would have liked to trade his resignation for having the charges against him dropped, it was never a real option for the prosecutors. Agnew’s lawyers negotiated a deal by which he could plead *nolo contendere* (no contest) to the single charge of income tax evasion and render his resignation as vice president of the United States in return for a promise that he would never have to serve any time in jail. The charge of *nolo contendere* is used when a defendant refuses to admit guilt but accepts punishment as if guilt were established. One condition of the agreement was that the vice president would waive his Fifth Amendment right to refuse to testify against himself. Agnew was fined \$10,000 and sentenced to three years probation.

In 1980, Agnew published his memoirs, *Go Quietly Or Else*. In the book, he reiterated his claims of innocence: “I am innocent of the allegations against me which compelled me to resign from the vice presidency of the United States in 1973.” The former vice president insisted that he had been removed from office by liberals who resented his conservative views.

Despite his pleas of innocence, Agnew admitted that he had taken payments while serving in political office in Maryland, but he again claimed that the money had not been intended to curry political favors. Agnew moved to California where he tried to claim a tax deduction for the fines he had been forced to pay the state of Maryland. His request was denied. In California, the former vice president

discovered that he had the right connections for a successful career in developing American business deals for foreign governments.

#### SEE ALSO

corruption; bribery; prosecution; tax evasion.

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## air pollution

PUBLIC RECOGNITION of the harmful nature of air pollution arose in the United States in October 1948 when, over a five-day period in Donora, Pennsylvania, an air pollutant emission lead to 19 deaths. Additionally, 10 percent of the population of Donora was severely affected by the exposure that was compounded by the effects of weather keeping the pollutants at ground level.

International attention to the issue of air pollution developed in 1952 when, in London, England, particulate matter and sulfur dioxide built up over a three-day period and caused 3,000 to 4,000 deaths. For decades the lead and chemical industry subjected workers and the public to a variety of hazardous air pollutants by withholding industry data reflecting its harmfulness and even developing trade associations designed to lobby legislatures, intimidate independent researchers, sponsor scientists to lie to the public about harmfulness of lead in the body, and pressure hospitals to withhold evidence about industrial poisoning of workers and the air.

The federal government began to legislate against air pollutants in the late 1940s and 1950s, but it wasn’t until 1970 that the Clean Air Act was passed mandating controls over the concentration and emission of a variety of pollutants, primarily those recognized as carcinogens and irritants. Polluting the air is against the law in the United States and has been since the Clean Air Act was passed. Although some types of air pollution are naturally

occurring, such as that emanating from volcanoes and the decomposition of vegetation, the most problematic forms of air pollution come from industrial sources including fossil-fuel fired electricity and a variety of manufacturing plants worldwide.

And although automobile and diesel exhaust remains a primary pollutant of the air, industrial air pollution remains one of the most significant sources of air pollution and remains a serious problem in the United States and globally. When air pollution exceeds allowable legal limits, or when forbidden chemicals are released or emitted into the air, this is a form of white-collar crime referred to as environmental crime. Like many other white-collar crimes, much of this air pollution is the result of industrial attempts to increase power and profits.

## CASE STUDIES

Another early case of air pollution involved Allied Chemical Corporations's production of Kepone, a toxic pesticide, related to DDT, that caused kidney lesions, liver problems, and nervous-system damage in laboratory animals. Allied Chemical initially licensed other companies to produce Kepone until 1966 when increased demand led Allied Chemical to manufacture Kepone at its plant in Hopewell, Virginia. This continued until 1973 when a new corporation, Life Sciences Products Inc., was formed by former employees who had the sole rights to continue the production of Kepone through 1974.

Conditions at the plant were poor and workers were constantly exposed to Kepone in the air. Within two weeks, workers at the plant began showing symptoms of exposure, and in two months the local sewage plant was found contaminated by the illegal dumping of Kepone by the plant. One year later, the plant was shut down after finding Kepone in a worker's bloodstream. In the end, more than 133 workers developed a variety of illnesses. Additionally, Kepone was found in air samples as far away as 64 miles from the plant. It was also found in fish and oysters nearby. Thousands of pounds of Kepone still lie on a nearby riverbed.

Two corporate officers pled guilty to over 100 counts of criminal violations of the Water Pollution Control Act, were fined \$3.8 million each and placed on five years' probation. Allied Chemical, convicted of crimes from its own misconduct in producing Kepone from 1971 to 1974, was fined \$5 million for over 940 counts and was forced to do-

nate \$8 million to the Virginia Environmental Endowment and clean up the remaining pollution. However, such costly burdens, as scholars point out, are borne by the stockholders of the corporation not the corporation. It was also found that the local Water Quality Control board as well as the Air Quality Resources Board, and OSHA and EPA investigators knew about the Kepone situation and failed to take action. But only the city of Hopewell was fined and given five years' probation.

The international trade in pesticide involves companies like Dow, Shell, Chevron, Bayer, Monsanto, Dupont, and Union Carbide. As far back as 1982, the international trade of pesticides has been big business. Then, 25 percent of pesticides exported by U.S. companies were banned, restricted, or unregistered for use in the United States due their hazardous nature. A variety of pesticides for lawn and garden use remain unsafe or untested. Other forms of environmental crimes are suspected in the extinction of over 300 species of animals, birds, fish, reptiles, amphibians, snails, clams, crustaceans and insects.

Union Carbide perpetrated one of the worst global incidents of air pollution in 1984. Union Carbide's Bhopal, India, plant released a harmful gaseous chemical, called liquid methyl isocyanate, after allowing a number of drums to rust and decay, while not making proper safety precautions to prevent injury and death. Union Carbide also failed to develop proper warning procedures for workers or local townspeople. The gas spread to the local community and the death toll was initially 3,415 lives, but eventually that figure increased to 10,000 with 200,000 more injured, and 40,000 of those seriously injured. Not until 1989 did Union Carbide settle out of court with victims' families and the Indian government for \$480 million. In 2003, only one-third of this money had been received. In 1999, seven Union Carbide employees went on trial in Bhopal for negligence. However, back in the United States, Union Carbide recovered financially by the 1990s and successfully merged with Dow.

## CLEAN AIR ACT AMENDMENTS

Through the years, the Clean Air Act has been amended several times with the last amendment passing in 1990. One of the most important elements of the Clean Air Act includes the conditions specified in the National Ambient Air Quality Stan-

dards (NAAQS). This requires the Environmental Protection Agency (EPA) to identify pollutants that “may reasonably be anticipated to endanger public health or welfare” and to issue air quality criteria.

The criteria must reflect the latest scientific knowledge and are set up by independent scientific review panels that consolidate the most current scientific research. Other data collected include that which help provide a better understanding of the nature, sources, distribution, measurement, and concentration of these pollutants. The EPA reviews the NAAQS every five years. These standards are of a short-term and long-term nature. There are primary standards designed to take into account the health of sensitive populations such as children, asthmatics, and the elderly, while the secondary standards are designed to protect against damage to animals, crops, vegetation, and buildings. As a result there are six hazardous air pollutants defined as contaminants, with EPA mandates for minimal levels of exposure into the air.

## POLLUTANTS

These include combustion related pollutants like nitrogen oxides, carbon monoxide, and a number of sulfur oxides including sulfur dioxide, a combustion related zone pollutant called O<sub>3</sub>, and lead referred to as criteria pollutants. Many of these pollutants come from industrial sources including coal gasification and fossil fuel power plants, and waste incinerators. Furthermore, many of these are associated with lung cancer. Additionally, fossil-fuel fired electric power plants emit a variety of carcinogens including chromium, nickel, and radionuclides.

Other carcinogens include carbon particles, particulate organic matter (or POM) that includes Polycyclic Aromatic Hydrocarbons (or PAH) and benzopurene. PAHs are also associated with lung cancer, particularly among workers exposed in steel plants, urban dwellers, and coal miners. Sulfur dioxide and oxides of nitrogen are produced through the combustion of fossil fuels that are then converted to further air pollutants once in the atmosphere.

Among studies that also control for individuals who smoke tobacco, the relationship between exposure to air pollution or industrial exposure to toxins and cancer remains strong. Air pollution from steel mills and municipal solid-waste incinerators

lead to increases in lung, stomach, liver, and colon cancer. Also the International Agency for Research on Cancer (IARC) has classified strong sulfuric acid aerosol as a human carcinogen among heavily exposed occupation groups. Butadiene, a volatile organic compound used since the 1930s in the synthetic production of rubber and emitted in automobile exhaust is also classified by the IARC as a probable human carcinogen. Aldehydes emanating from the combustion of gasoline and diesel fuel are also classified as hazardous air pollutants.

Volatile organic compounds are chemicals emitted from both human-made and naturally occurring sources including automobiles, chemical plants, oil refineries, factories, and consumer, commercial products, and plants. These react with nitrogen oxide to form O<sub>3</sub>, which can develop from sources hundreds of miles away. While O<sub>3</sub> is a primary pollutant regulated by the EPA and the NAAQS, about 48 million people live in 77 counties where O<sub>3</sub> levels exceed the national standards. Most of these concentrations are in Houston, Texas, Los Angeles, California, in the Gulf Coast areas, and the north-eastern and north-central states.

However, some improvements in air quality in the United States have been made. For example, all monitoring locations across the country have met the standards emission criteria for nitrogen dioxide from 1992 to 1997. Nonetheless, other problems with pollutants exist and include the development of greenhouse gases responsible for the depletion of the ozone layer of the atmosphere.

One of those is carbon dioxide, released into the atmosphere from the manufacture of aluminum and steel as well as the production of fossil fuels (coal, oil, and natural gas). Another pollutant that harms the ozone layer is chlorofluorocarbons (CFCs) and, while it is illegal to sell this substance, it is the second most valuable commodity traded out of Miami, Florida, next to cocaine. CFCs are used as refrigerants and aerosol propellants and are also found in air conditioning units.

Carbon monoxide emissions decreased in the United States from 1988 to 1997, with the exception of three large counties in which over 9 million people lived. Most carbon monoxide emissions are from car exhausts, but other sources include industrial processes and other forms of fuel combustion. Lead emissions have also dropped by 98 percent between 1970 and 1997 due to use of unleaded gasoline for autos. However, the highest concentrations

of lead are now found around nonferrous smelters and other industrious stationary sources.

## POLLUTANTS IN CONCERT

Carbon monoxide effects are usually isolated to specific occupational groups but the effects of carbon monoxide cannot be separated from the effects of other pollutants. The effects of nitrogen oxides, usually occurs in concert with other pollutants, but by itself can combine with water in the lungs to form nitric and nitrous acids that are believed to damage the lung oxidation mechanisms. At high concentrations, nitrogen oxides can cause fatal pulmonary edema and pneumonia. Much exposure to this chemical comes indoors from gas ovens and space heaters, but one can also be exposed while driving in traffic.

The EPA also regulates what are called hazardous air pollutants, also referred to as toxins, and industries are required to use technology to limit the emissions of such chemicals. Some of these industrial air pollutants have been linked to cancer, including particulate matter (PM), monitored by the EPA since 1988, that can be inhaled into the lungs. PM includes solid or liquid particles in the air, and although some PM is natural like pollen, PM is also produced from fuel combustion activities. Larger particles tend to come from natural sources while smaller particles tend to come from industrial sources.

These smaller particles tend to lodge deeply within the lungs while the larger particles will deposit in the upper airways. Prior to 1988, the EPA only measured total suspended particulates (TSP) and that included particles too large to be inhaled into the lung. PM also has deleterious effects on those individuals with asthma, lung diseases, and heart diseases. Particulate matter has been found to be significantly related to cancer mortality rates in multiple studies.

Other effects include emergency room admissions for a variety of cardiovascular problems as well as pneumonia and respiratory ailments. While decreases in these particles have been noted from 1970 to 1980, little change has occurred since 1990. From 1988 to 1995, the annual mean concentration of PM<sub>10</sub> has dropped by 17 percent, but recent trends are not known.

Finally, the EPA also controls emissions of sulfur dioxide and nitrogen oxide in order to reduce



*Fossil fuel production, such as an oil refinery, is the greatest air pollutant in the United States and worldwide.*

the production of acid rain. Fossil fuel combustion accounts for 85 percent of all U.S. sulfur dioxide emissions. Many of these dangerous chemicals, including sulfur dioxide and particulate matter, and acid aerosols, usually have common industrial sources. Many industrial air pollutants are carcinogenic and include those emanating from the combustion of fossil fuels for both transportation and power generation.

One such chemical includes polycyclic organic matter or POM. POM comprises a variety of chemical compounds including polycyclic aromatic hydrocarbons (PAHs) and nitroPAHs. These are released into the air by combustion processes including, fossil fuel combustion, diesel engine emissions, tobacco smoke, grilling meat, and chemical and photochemical reactions in the outdoor environment. One form of POM includes benzoaprene. PAHs are associated with increased risk for lung cancer in a variety of occupation settings including coke-oven workers in the steel industry and coal gasification workers. Some of these toxic substances that are not considered primary pollutants are also negatively related to health and positively related to mortality.

And while air quality has improved in the United States since the 1970s, 52 million people still live in counties across the country where the air quality does not meet the required standards for at least one primary pollutant. Additionally, many developing nations across the globe are also suffering from air pollution at levels higher than current levels in the United States. This is primarily the result



of economic globalization and the movement of transnational corporations to third world and developing nations where environmental laws are less stringent or nonexistent.

The EPA has been responsible for evaluating the risk of over 189 hazardous air pollutants emanating from specific point sources since the Clean Air Amendment Acts of 1990. Most of their data on outdoor air pollutants is not usually gathered from point sources. However, scientific studies have examined differences in industrial air pollutants between urban and rural areas as well as areas in closer proximity to industrial pollutant points and hazardous waste sites, and continue to find increased risk for cancer for people in urban areas, workers exposed to the above pollutants, and people living in closer proximity to hazardous waste sites and steel and power plants.

Since 1981, the World Health Organization under the United Nations Environment Program and the Global Environmental Monitoring System has been monitoring a variety of air pollutants including total suspended particulates as well as sulfur dioxide (the relationship between simultaneous levels of both these chemicals in the environment is quite high). Both have been found to be predictive of daily cardiovascular mortality levels resulting from air emissions from industrial activities and coal-burning especially in developing nations.

The trade in ozone-depleting substances has been illegal since 1987 in concert with the Montreal Protocol on Substances that Deplete the Ozone Layer. Two newer international laws also prohibit specific types of air pollution but neither is currently in force, this includes the 1998 Rotterdam Convention that prohibits the use of certain chemicals and pesticides, and the 2001 Stockholm Convention on the prohibition of persistent organic pollutants.

#### SEE ALSO

Allied Chemical; Union Carbide; Clean Air Act.

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## Allied Chemical

THIRTEEN YEARS AFTER the discovery that Allied Chemical, one of Virginia's major employers, had knowingly discharged the pesticide kepone into the James River, the waterway was fully reopened to fishing.

From 1966 to 1973, Allied Chemical produced kepone at a small plant converted from a gas station in Hopewell, Virginia. After 1973, the plant was operated by two former Allied employees under the name Life Science Products Company. Its sole customer was Allied; its sole product was kepone. In 1975, Virginia closed the plant after workers developed the "kepone shakes," a characteristic tremor caused by overexposure to the chemical. Overexposure can also cause liver damage and temporary sterility. Kepone, a grayish white powder used in ant traps and to kill potato and banana plants, was banned in the United States that year.

The state also discovered that the factory had illegally disposed of large quantities of waste containing kepone. Life Science Products discharged kepone to the local sewage system, which was not equipped to handle it; Allied Chemical discharged kepone directly to the James River. Because kepone accumulates in organic tissues, Governor Mills E. Godwin banned all fishing on a 100-mile stretch of the river.

As the Virginia fishing industry staggered under bad publicity, Godwin and chemical industry lobbyists asked the U.S. Environmental Protection Agency (EPA) to raise the permissible level of kepone in fish, arguing that studies showing links to cancer were flawed. In late January 1977, U.S. District Judge Robert R. Merhige levied a record \$13.2 million fine against Allied Chemical, which pleaded no contest to 940 counts of illegal dumping. By

February 1, he had agreed to reduce the fine to \$5 million if Allied Chemical created an \$8 million environmental fund for Virginia. Merhige declared that the company's managers were "good boys in my book." The fund would be administered by a board of local philanthropists.

Although Merhige commented, "I cannot believe that the board of Allied sat somewhere in New Jersey and said, 'Let's go pollute,'" the Securities and Exchange Commission (SEC) disagreed. In March 1977, the SEC charged Allied Chemical with neglecting to inform its investors that it was knowingly polluting the environment, thereby distorting the firm's financial risks. The company and the SEC immediately signed a consent agreement in which Allied promised not to do it again. That October, the state of Virginia levied its own \$5.25 million fine for environmental clean-up. By April 1978, the company had settled personal injury suits with 30 male workers, 8 wives, and 12 infants who were exposed to kepone.

Allied reappeared in the news in 1982, when it shattered the mutual stock-buying death grip of Bendix and Martin Marietta by buying both, then selling Martin Marietta back to itself. After multiple acquisitions and divestments, the company merged with Honeywell.

#### SEE ALSO

water pollution; Environmental Protection Agency; Securities and Exchange Commission.

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## Allied Irish Banks

ALLIED IRISH BANKS (AIB) is the Republic of Ireland's largest banking and financial services organization. The company was formed in 1966

through an alliance of three banks dating from the 19th century: The Provincial Bank, The Royal Bank, and The Munster and Leinster banks. They are now a global organization operating predominantly as a retail and commercial bank with representation in Europe, the Pacific Rim, and the United States.

Worldwide, the AIB Group has 800 offices, 25,000 employees, and approximately 40,000 shareholders. In terms of capital it is ranked 164th out of the world's top 1,000 banks having assets of about \$40 billion. They have strong franchises in the Republic of Ireland, Northern Ireland, Great Britain and Poland and are also a key investor (22.5 percent stake) in the large U.S. regional bank M & T Bank Corp, which has been one of the most successful regional American banks.

#### FRAUD SUSPICION

At the beginning of 2002, AIB suspected fraud at its U.S. subsidiary, Allfirst Financial Inc., a revelation that fueled jitters about the reliability of corporate accounting. AIB's history with Allfirst began in 1983 when it bought a stake in First Maryland Bancorp. In July 1997, AIB purchased Deposit Corporation which was merged with First Maryland Bancorp to form Allfirst in 1999.

Allfirst surprised the business community on February 6, 2002, declaring that it lost millions at the hands of John Rusnak who covered up losses by doctoring computer and other internal bank records over a five-year period, mostly by trading Japanese yen, without being detected. Shares of AIB fell in the New York, London, and Dublin stock exchanges. Immediately after, AIB announced that it had enlisted the aid of the U.S. Federal Bureau of Investigation to find the trader it suspected of being responsible for the fraud. The debacle resulted in extensive changes in Allfirst's executive suite, the firing of seven employees and the sale of the Baltimore bank to Buffalo-based M&T Bank Corp.

The company suspended nearly all foreign exchange trading and, in 2003, suspended five executives at its treasury operations pending the completion of the investigation. Rusnak pleaded guilty to fraud charges in connection with a scheme to hide nearly \$700 million in losses at the bank. Prosecutors said Rusnak fabricated trades to cover losses and maintain his salary and bonuses. He was charged with fraud and false entry to bank records

after the investigation showed that he had been entering fictitious information into the bank's computerized record system to conceal his trading losses and generate false "paper" profits.

Allfirst's parent company agreed to sell the U.S. subsidiary in 2002 to M&T Bank in a deal valued at about \$3 billion. Later, Allied sued Citibank and Bank of America seeking to recover \$500 million in compensatory damages; the share of losses is attributed to the bank's alleged wrongdoing. A lawsuit, filed in U.S. district court in the Southern District of New York suspected that employees of Bank of America and Citibank "joined Rusnak's scheme" because they "agreed to operate the accounts in ways that systematically concealed the actual risks and results of Rusnak's trading from Allfirst." On September 7, 2000, Rusnak proposed that Bank of America send daily trade confirmations to Allfirst in a format he created. Eight days later, he made the same request to Citibank. Rusnak's recap format omitted essential elements such as profit and loss information, the price of his open position in each currency, the risk in the position or its current value. The banks also agreed not to confirm each Rusnak trade, in violation of standard brokerage and industry practice.

#### SEE ALSO

bank fraud; insider trading; stock fraud.

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## American Civil War

PEOPLE PROFITED, some unduly, from the Civil War as from all wars and other times of rapid expenditure of government funds. A common perception is that the corruption and taking of excess profits (profiteering) came about in part because the secretary of war, Simon Cameron, was a conniver and a hack whose sloppy practices allowed profi-

teers to foist on the government defective weapons, uniforms, and other equipment in violation of President Abraham Lincoln's order that all contracts be sent out for competitive bids.

Actually, it was somewhat more nuanced than that. There is little evidence about procurement and profiteering in the South, but profiteering presumably occurred there as it did in the North, especially during the war's early stages. The initial phase of war is chaotic, and until the system becomes ordered there will be those who take advantage. The system was designed for a much smaller force, a more leisurely pace, a shorter war. The initial procurement effort was haphazard, disrupting the civilian economy in the haste to field armies.

The federal expectation of the war need was 250,000 Union troops for maybe 90 days. The army reached 1.7 million before the war ended four years later. The new kind of war started while experts still debated whether to continue privateering and the sharing of prizes taken at sea. Profiteering occurred in every way anyone could imagine to make money off new technology: steamships, railroads, machine tools, and more complex weapons. Patent royalties, high salaries for executives, stock speculation and manipulation—these were new avenues as well. Shoddy millionaires arose, but before profiteering became outrageous, the procurement service federalized, organized, and streamlined.

#### SHODDY UNIFORMS

Initially, the states bought uniforms. New York contracted with Brooks Brothers in April 1861 for 12,000 uniforms. The company produced 5,000 uniforms in a week and the rest shortly thereafter. The contract was improperly let, with only 24 hours' bid notice, with insider information and a gift to the wife of the state treasurer, who signed the contract. The price was \$20.00 per garment, but later military uniforms would be contracted at \$18.00.

The clothier used lighter weight and, in some cases, rotting cloth. These shoddy uniforms had the look of better quality army-specified wool. Poorly cut and ill-fitting garments sometimes lacked buttons or buttonholes. Brooks Brothers claimed that the damaged goods were only 500 of 36,000 uniforms it made. New York State said it was a majority. Brooks Brothers replaced 2,350 uniforms, a value of \$45,000. The episode was embarrassing to

the state and the clothier because it happened in the middle of the media capital, New York City. It gave a new label to the shoddy aristocracy, the “shoddyocracy,” whose homes had shoddy pianos “all case and no music,” shoddy carpets “brilliant colors and little wool,” and so on. Philadelphia, Pennsylvania, had a similar scandal full of cronyism, fraud, and inferior product.

## RAILROAD PROFITEERING

The first controversy came in getting troops to protect the capital. Secretary of War Cameron’s family owned the Northern Central, one of only two connections from the north. Cameron had the duty of deciding how many troops traveled on his family’s line and at what price. There was an unavoidable conflict of interest. In the western states, the railroads had colluded three years prior to the war; troops would ride at first class rates only, and they would have only 80 pounds of baggage each.

The Pennsylvania governor noticed that passenger rates for Pennsylvania volunteers varied from two-and-a-fourth to three cents per passenger mile. He convened a meeting of 21 railroads and established a rate of 2 cents per passenger mile. In return, the railroads got local rates for freight instead of the cheaper through-rates.

Cameron’s assistant for railroad matters, Thomas A. Scott, was on leave from the Pennsylvania Railroad due to a conflict of interest because he was working in government on matters affecting his company, the same as Cameron and the Northern Central. When the Baltimore & Ohio (B&O) Railroad, suspected of Confederate sympathies anyway, tried to charge 3.75 cents per mile, Cameron and Scott forced B&O rates down by routing traffic onto their railroads. This act appeared to be diverting business for their own profit, but it did save the taxpayers money, and the B&O still did fine with its traffic increasing from 8 to over 400 cars a day within a year. Even when Scott set the national rate at Pennsylvania’s 2 cents, railroaders made a profit: their rate for passenger cars was 1.33 cents, and for troops carried in freight cars profits were from 50 to 122 percent. The government reduced rates in 1862 and also acquired the power to take over lines for reasons of public safety; in return, it allowed railroads to lessen competition.

Railroad revenues increased 10 percent in the war’s early months, and Cameron’s railroad’s prof-

its were up over 44 percent in the first year. Scott’s Pennsylvania Railroad increased earnings from \$5 million in 1860 to \$17 million in 1865. The B&O grew from \$31.6 million to \$43.1 million. The small Philadelphia, Wilmington, and Baltimore Railroad profit increased from \$236,000 in the last year of peace to \$1,645,000 in the war’s first year. In 1864, American Express, hauler of freight and corpses, paid a 35 percent cash dividend as well as a 50 percent stock dividend.

## SHIPPING

For the North, to blockade and invade the Confederacy required a massive increase in ships. The 4 million tons of maritime shipping available in the summer of 1861 would be insufficient to blockade the South and transport Northern troops. To quickly enlarge the fleet, the navy used commission agents to purchase or lease ships. Commissions typically were 2.5 percent. The chief agent chosen was George D. Morgan, cousin of the governor of New York and brother-in-law of Navy Secretary Gideon Welles. For procuring 89 ships (at a savings of \$900,000 below asking price), Morgan got a commission of \$95,008, more than Lincoln’s salary for four years. The critics asked if Welles might have negotiated a better deal than 2.5 percent, given the volume involved. Morgan left for a European vacation.

Congress investigated exorbitant fees for charters, failure to advertise contracts, and navy contracts let for up to 40 percent above the going rate. Bribery was part of the expense of contracting too, with contractors paying 2.5 percent commissions or higher to naval agents. Those same agents sometimes sold the navy ships they owned themselves, or had agents buy vessels at reduced prices then sold them to the navy for markups of 50 percent or higher. One shipbroker, W. H. Starbuck, had a friend buy two whalers for a total of \$6,500; then he sold them for \$14,550. The partners split the \$8,050 profit, and Starbuck got a commission of 7.5 percent of the deal. The navy did make him refund \$6,166.

The navy initially paid excess rates for shipping, but once it realized that the conflict would be long, the navy began bargaining better, getting price reductions and better ships, even negotiating refitting as part of its deals. More problematic was the condition of the ships. When Cornelius Vanderbilt’s

*Niagara*, almost foundered, investigators found that it had rotten beams, and life preservers for only 20 percent of the passengers. Worse, it was a lake-going vessel overloaded with soldiers and gear, ill-equipped to handle the Atlantic Ocean. The lease rate of \$400 per day was generous; operating costs were about \$100 per day, but the big problem was Vanderbilt's chartering of a lake-going ship in the first place. Use of vessels for war purposes meant insurance rates as high as 33 percent of the ship's value or 10 percent per month.

### FIREARMS AND PROVISIONS

At the war's onset, the government produced its own arms, but the Springfield armory could produce only about 3,000 weapons a month. To arm the million-man force, the armory would need 28 years. So the government began soliciting arms from private contractors at home and abroad. Generally the contracts were prepared in haste both to arm the North and to keep the South from getting arms. The government paid a premium, a significant profit, but as the initial flurry slowed, the government became more adept at negotiating prices down, especially for follow-on orders and large volume contracts.

Arms-making was profitable, in peacetime returning 10 percent; during the war, profits peaked at 42 percent in 1863 but averaged under 30 percent for the other years. The only excess profits came when the large, efficient manufacturers benefited from a price schedule designed to ensure profits to the smaller and less efficient makers. Inventors and manufacturers of technically innovative weapons, such as the breech-loading rifle sometimes demanded and got large royalties or prices well above average. The breech-loader could cost \$35 whereas a standard carbine cost \$20.

Cannon foundries could charge exorbitantly as well: the West Point foundry in Cold Spring, New York, provided about 20 percent of Union cannons. The superintendent and his partner earned \$278,000 and \$95,000 respectively in 1864, and the tax system was such that their taxable incomes were \$13,900 and \$4,600 respectively. The system wasn't set up to capture the excess profits.

Windfall profits came with the fortunes of war. North-South railroads lost money while East-West lines had great profits. Contractors could receive generous profits for taking risks, or they could lose

everything if the war caught them at a bad time. Cotton and textile speculation was highly lucrative because of the expectation that the supply of cotton would fall. Newsprint and newspapers both were profitable, and naval hardware and stores profits resulted in another Congressional investigation. In the case of Smith Brothers and Co., supplier of naval hardware, average annual sales nearly quadrupled during 1861–63 from the prewar 1860 total of \$150,000. A partner in the company did admit that his prices were above the market low. Merchants did have to wait six months to receive payment in discounted certificates, and they had credit problems because banks didn't accept navy vouchers as collateral.

### SPECULATORS AND PLUNDER

In an inflationary environment, speculation was inevitable. Cheating was too, as in the case of the ring that sought to control the telegraph wires so they could invest based on their prior knowledge of the battle of Chancellorsville. Speculation could be in foreign credits or gold, and the latter led to hoarding and large brokerage commissions and heavy telegraph traffic. Even Southerners speculated in Northern gold. And late in the war, rumors of peace tumbled the stock and gold markets.

The illicit trade was primarily in cotton, but Southerners did try to buy arms before the war. Commerce continued throughout the war. Lincoln licensed cotton traders with the South because he preferred to buy it direct rather than through England, which would have increased the price sixfold. His special licenses caused rumors of bribery and corruption.

General Nathaniel P. Banks required that all cotton purchases be made in Northern greenbacks. Although Southerners didn't want the Yankee currency, they used at least some of it to buy war materiel in Europe. Southerners sometimes demanded payment in gold or salt, and even though the salt trade was outlawed in 1862, it continued with the acquiescence of Confederate President Jefferson Davis. Smugglers were mostly in the border states or Texas, but some Rhode Islanders participated as well.

The laws of plunder remained in effect for the navy but not the army, leading to some occasional abuses, such as the capture of Union cotton that was then branded "C.S.A." and sold. Raiders plun-

dered, as did General Neal Dow, who confiscated furnishings and art objects for his home in Maine; an 1880 Supreme Court decision affirmed the right to plunder. Pilferage, theft, bribery, and cheating were also elements of the trade in plundered goods.

Some people made a living by enlisting repeatedly. The maximum enlistment bonus was \$8,000. Bounty jumpers collected the bonus, disappeared, and enlisted again and again. The record was 32 times. Substitute brokering was another money-maker: for a price, agents would provide substitutes who would sometimes jump bounty or prove unfit. There was also fraud in billing for housing of enlistees, fraud that totaled \$700,000 during the war.

## REGULATION AND POSTWAR

Scandals became widely known, leading to the Frauds Act of 1863, also known as the False Claims Act and the Lincoln Law. The whistleblower provision reduced degraded quality but not price gouging, which was difficult to prove. The government also attempted to run its own arsenals and bakeries and other industries to reduce profiteering. Moral suasion and voluntary anti-luxury campaigns, and the progressive income tax helped, as did renegotiation of contracts and other federal efforts.

Some sacrificed rather than profited. Some railroads refused to charge for transporting troops, some ship owners donated their vessels at no or low cost, and some businessmen sold below cost or brokered European deals and bought spies with their own money. Donations came in the millions from such organizations as the Union League Club and the U.S. Sanitary Commissions, but evasion and exploitation got the headlines even as "shoddy" became a historical term by 1865.

The profiteers didn't make fortunes from the war, but some profiteers did go on to marked success after the war, in part from the capital they amassed during the profit-taking years of the war. John D. Rockefeller was a Cleveland commission merchant who invested his wartime profits in an oil-refining business; eventually the Rockefeller investment turned into Standard Oil. Philip D. Armour anticipated that Union victories would end the war. He sold pork short, making millions. He invested his war profits in a Chicago pork packing house. J.P. Morgan sold uniforms and arms during the war. He bought guns from the government, upgraded them, and then sold them back at highly profitable prices.

He also speculated in gold. Others who speculated and won were the half-a-dozen individuals who built the American transcontinental railroad, another example of inflated prices and exorbitant profits: profiteering.

## SEE ALSO

False Claims Act; Rockefeller, John D.; Morgan, J. P.; antitrust.

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## American Cyanamid

THIS CHEMICAL company's record-setting activities included the nation's largest corporate contribution to a superfund site cleanup, above-average toxic waste releases, and the largest fine for an air permit violation in New York state. This last record earned the company its number 93 spot in Corporate Crime Reporter's Top 100 Corporate Criminals of the 1990s.

Named for a derivative of a toxic chemical used in pesticides, calcium cyanamide, American Cyanamid manufactured dyes, paints, pharmaceuticals, and other chemicals. In 1929, the company bought Lederle Laboratories, which was already operating a manufacturing plant in Bridgewater Township, New Jersey. Much of the 575-acre site, which sits atop New Jersey's second largest aquifer, became contaminated with chromium, lead, mercury, benzene and toluene, as wastes generated by manufacturing were simply dumped on the property. When Cyanamid settled with the U.S. Environmen-

tal Protection Agency (EPA) in 1988, their \$84 million contribution to cleaning the site was the largest ever corporate share of a superfund site cleanup. The site has since been redeveloped as Bridgewater Promenade, a shopping center with major discount retailers.

Cyanamid's handling of wastes remained dubious into the early 1990s, when protesters rallied to prevent the company from sending 5,000 to 9,000 pounds of mercury wastes to a recycling plant in South Africa with a record of toxic leaks. The South African government responded by barring foreign toxic wastes from entering the country. Cyanamid already had a poor reputation there due to its firing, over pension disputes, of 200 workers at a South African plant. George J. Sella, then chief executive officer of Cyanamid, defended past mercury shipments to shareholders in April 1990, disputing widespread mercury poisoning in the Natal region around the recycling plant: "I am absolutely satisfied that there is no contamination possible from the activities that we are involved in."

## RECORD FINES

In 1991, the *New York Times* noted that American Cyanamid's toxic releases per \$1,000 in revenues remained quadruple that of other chemical manufacturers. As of late 2003, the Bridgewater facility was listed by the EPA as a High Priority Violator under the Clean Air Act, with the state of New Jersey responsible for monitoring the facility's plans to improve its performance. A second facility, listed in the West Windsor Township of New Jersey, had been in violation of its Clean Water Act permit continuously since at least July 2001.

Cyanamid's \$250,000 air permit violation, a record in New York state, was earned not by excess emissions, but by building an un-permitted power plant. The company had knowingly begun construction of a \$22.5 million cogeneration facility at its Pearl River labs without obtaining required air emission permits. Cyanamid pled guilty to a single misdemeanor count.

These record-setting activities were by no means the end of Cyanamid's brushes with the law. In 1997, professors Robert Allen and Paul Seligman of the University of Colorado successfully sued Cyanamid for stealing their formula for prenatal vitamins that offered better iron absorption. Asked to study improvements to Cyanamid's Materna vi-

tamin, Allen and Seligman discovered 11 years later, in 1993, that their work had been patented under the name of a Cyanamid employee. At the time of the suit, Materna's sales were estimated at \$300 million. In September 2003, a federal appeals court upheld the award of damages to the university and its researchers, setting the amount at \$56 million.

In 1994, American Cyanamid was acquired by American Home Products (AHP), owner of A. H. Robins Company of Dalkon Shield notoriety, for \$9.6 billion. Renamed Cyanamid Agricultural Products, the company staked its future on EPA approval of the pesticide chlorofenapyr. Intended to be used to control beet armyworm on cotton, chlorfenapyr was shown in testing to be harmful to bird and fish reproduction, as well as to persist in the environment. In October 1999, the EPA refused to approve the pesticide; AHP immediately announced restructuring of the Cyanamid division. (AHP later returned to the name of one of its subsidiaries, Wyeth.)

Less than a year later, German chemical company BASF outbid rivals Bayer, Dow, and Sumitomo Chemical to purchase Cyanamid from AHP for \$3.8 billion. The company settled in November 2002 for \$75,000 an Equal Employment Opportunity Commission suit brought on behalf of two men whose job offers were withdrawn after they tested positive for diabetes. As of April 2003, the company was being compelled by court order to surrender records related to an alleged policy of requiring special annual medical testing for employees diagnosed with diabetes.

Potential liabilities for Cyanamid's paint manufacturing operations were, however, the responsibility of New Jersey-based Cytec Industries, Inc., the specialty chemicals manufacturer that had been spun off from American Cyanamid shortly before the 1994 AHP takeover. In March 2000, Santa Clara County, California, filed a suit against American Cyanamid and seven other major paint manufacturers, alleging that these companies had known about the potential health hazards of lead paint since 1904, but continued to market the product into the 1950s.

The suit, joined by 11 other San Francisco Bay Area governments seeking to recover costs of removing lead paint from their buildings, was dismissed on the grounds that it should have been filed within three years of when the paint was applied. A similar suit in Rhode Island ended in a mistrial.

## SEE ALSO

air pollution; Clean Air Act; Environmental Protection Agency.

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## American Hospital Supply

MERGERS AND MONOPOLIES were the strategic focus of this large hospital supply distributor throughout the early 1980s. A reluctant merger with Baxter Travenol fell apart a decade later while the combined company was fighting product liability lawsuits for leaking silicon breast implants.

In 1982, the last year before the federal government slowed growth in the healthcare industry by introducing fixed-rate Medicare reimbursements, American Hospital Supply (AHS) pursued a strategy of obtaining exclusive contracts with Voluntary Hospitals of America (VHA), the largest group of non-profit hospitals in the United States. A federal

judge ruled that the contracts were an illegal conspiracy and awarded damages to smaller suppliers.

The subsequent slump in the healthcare industry did not prevent AHS from pursuing a more formal vertical merger. In April 1985, AHS announced an intended merger with Hospital Corporation of America. The estimated \$6.6 billion value of the resulting company would have put the merger among the largest in history. While analysts touted the merger as economically sound, HCA president Dr. Thomas Frist dismissed antitrust concerns, assuring *New York Times* that "[T]his will be looked on as a favorable merger, whereas 10 or 15 years ago it would have been a negative from the point of view of size."

Members of VHA disagreed, declaring that they would seek other suppliers. Pharmaceutical and medical device manufacturer Baxter Travenol seized the opportunity to prevent the AHS-HCA merger by making its own offer for AHS. The Baxter deal, initially rejected by AHS' board, promised increased efficiency through a horizontal merger of manufacturer and supplier, similar to the informal arrangement AHS and Baxter had until 1964.

Unlike the old-fashioned stock-for-stock swap of the AHS-VHA deal, the Baxter offer's promise of cash payments for stock excited the interest of arbitrageurs, whose involvement may have allowed Baxter to ease AHS into the deal without resorting to a hostile takeover. Some Baxter shareholders contended that they were coerced into approving the deal, thanks to a clause that promised AHS \$300 million in damages if Baxter had to back out. The suit was settled with minor changes to the deal. Baxter bought AHS for \$3.74 billion, among the largest deals of 1985.

Although Thomas G. Cody, Baxter's vice president of human resources, called the combination a success, Baxter may have acquired some surprises. AHS had been mired in disputes with the Internal Revenue Service over income dating as far back as 1973. Though AHS had won these disputes, Cody notes that some Baxter units continued to question the accuracy of AHS accounting procedures.

A more expensive problem was product liability suits over leaking silicone breast implants, inherited from AHS subsidiary Heyer-Schulte. As litigation against implant manufacturers mounted, investigations suggested that manufacturers had known since the early 1970s that implants could deteriorate, leak, and increase breast cancer risk. Among



the evidence was a 1976 "Dear Doctor" letter from Heyer-Schulte warning of potential implant ruptures. Baxter's 1996 annual report noted that the company faced 6,855 lawsuits and 1,776 pending claims, plus additional class action suits. The number had increased since 1994, when Baxter contributed \$556 million to a fund for implant compensation.

In November 1995, Baxter announced that the AHS merger had failed to produce the expected synergies. Most of the former AHS businesses were spun off in September 1996 as the public company Allegiance Healthcare. Potential implant liabilities remained with Baxter, which had won 24 implant suits by early 1997. Allegiance was acquired in 1999 by CardinalHealth, a horizontal combination of medical device and pharmaceutical distribution businesses.

#### SEE ALSO

breast implants; accounting fraud; antitrust.

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## American Motors

AMERICAN MOTORS Corporation (AMC), the auto manufacturer with a reputation for appealing to squares, became hip in the early 1980s with what may have been the most dangerous vehicle on the market. By the time the Jeep CJ line was discontinued in January 1986, more than 570 lawsuits worth upward of \$1 billion had been filed. Most cited the

vehicle's tendency to roll over during routine driving conditions.

The Jeep was developed in 1940 to meet the U.S. Army's need for an off-road reconnaissance vehicle. The winning bidder, Willys-Overland, designed a 4-foot-high, 11-foot-long four-wheel-drive vehicle that quickly became beloved by soldiers. In the 1950s, while working on an improved military Jeep, Willys-Overland marketed a civilian version. Upon acquiring the Jeep business in 1970, AMC separated the military and civilian divisions.

The civilian Jeep market took off in 1982, just as the Army was switching from Jeeps to Hum-Vees, said to be better for launching weapons. A year earlier, the Insurance Institute for Highway Safety had declared the Jeep CJ5 "the most dangerous thing on four wheels," citing a fatality rate higher than that of motorcycles. The Insurance Institute's road tests found three out of four CJ5s would flip when rounding an ordinary 90-degree corner at 22 miles per hour. AMC blamed the auto's poor safety record on driver error.

While the National Highway Transportation Safety Board (NHTSB) denied any need to investigate Jeeps, the Federal Trade Commission (FTC) required that a warning sticker be attached to all Jeep CJ5, CJ6, and CJ7 models, starting in early 1982. The label informed drivers that Jeeps, with their narrow wheelbase and high profile, do not handle like passenger cars.

A 1983 prospectus for AMC predicted lawsuits totaling \$2.5 billion for rollover-related injuries. The next year would bring the highest verdict to date against AMC: \$3.8 million in punitive damages for the 1980 death of 18-year-old Carrie Dustman in a rollover. However, injury claims were more typically settled out of court in confidential agreements, leading later litigants to complain that they would never have driven a Jeep if its dangers were known.

Consumer groups clamored for AMC to halt production and recall existing Jeeps. Faced with sales that dropped 50 percent from 1984 to 1985 and losses near \$29 million, AMC said that safety issues and litigation were not behind its December 1985 decision to stop making the vehicles. The Jeep would be replaced by a more comfortable sport utility vehicle (SUV), the Wrangler YL. "This is really to meet the demands of Yuppies," said AMC spokesman Jerry Sloan. "They want a more comfortable vehicle to drive when they have an attaché

case in the front seat and their Burberry coats folded in the back seat." In Los Angeles, where Jeeps had become status symbols comparable to Mercedes and BMWs, Jeep fans rallied unsuccessfully to keep the CJ5 in production.

Jeeps were never recalled, despite consumer advocacy group claims that more than 200 people died in Jeeps in 1989 alone. A NHTSB study in 1990 found that Jeeps were four times more likely than passenger cars to roll in single-vehicle crashes, with a 38 percent rollover rate for Jeeps made before 1981 and a 32 percent rollover rate for those made after 1981. Nonetheless, the NHTSB absolved the vehicle's maker of any responsibility, stating that Jeeps were safe if driven properly. At that time, about 420,000 Jeeps were still on the road, out of more than 600,000 sold between 1972 and 1986.

AMC and its Jeep division became subsidiaries of Chrysler, now DaimlerChrysler, in 1987. Vehicles sold under the Jeep name now include the Wrangler, which most resembles the original Jeep, and the Grand Cherokee, one of the most popular SUVs. In October 2003, the NHTSB released the results of its first round of rollover testing for SUVs. The 2003 Jeep Wrangler scored moderately well with a rollover risk between 20 and 30 percent. The Grand Cherokee posted a rollover risk between 30 and 40 percent.

Another Jeep model, the no-longer-produced Wagoneer, became a litigation target for multiple design defects. In 1989, AMC agreed to a confidential settlement of \$18 million for negligence after a Long Island boy died when his neck became caught in the power window of a 1986 Grand Wagoneer. In January 2003, a suit was filed by the families of three young women killed when their 1983 Wagoneer survived a collision only to burst into flames due to an alleged defect in the fuel system.

#### SEE ALSO

automobile; Nader, Ralph; consumer deaths.

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## American Revolution

IN APRIL 1775, the first shots were fired at Lexington and Concord, Massachusetts, plunging the American colonies into the Revolutionary War. Just more than a year later, in July 1776, the Continental Congress endorsed the Declaration of Independence, providing legitimacy for the fight for independence from England, then the world's greatest power. When the young nation entered the war, it had only a weak central government; there were no efficient governmental organizations to take charge of procurement for the American troops. The overall result of the lack of organization was chaos, waste, inefficiency, and corruption.

Profiteers were quick to take advantage of the government's shortcomings and to use the emergency situation to their own advantage. It was not uncommon for American troops to go without food, clothing, or blankets while local merchants, profiteers, and speculators grew rich and powerful. Scholars who study the Revolutionary period have estimated that the number of profiteers might have been as high as 90,000 compared to the 100,000 or so who composed the military might of the various armies. Profiteering methods included price-gouging, speculation, plunder, theft, fraud, privateering, ransom, hoarding, and trading with the enemy.

The Continental Congress understood from the beginning that Americans would expect to make money from the Revolutionary War. In 1776, Congress established the Secret Committee of Trade, which stated that the government would be "willing to allow what might be a reasonable compensation without being willing to submit to extortion." Congressional inexperience led to several serious mistakes, such as duplication of services. Duplication meant that different governmental agencies often competed for the same goods, raising prices even



*An American supply train at Valley Forge, Pennsylvania, was a typical opportunity for war profiteers.*

higher. The government often found itself in a no-win situation because it was forced to pay inflated prices to obtain necessities for the troops. Once the inflated price was established, merchants were unwilling to accept a lower price for the item, and the cycle continued. Profiteering was not limited to the private sector but also occurred within the American and British militaries and was common in government.

### MILITARY PROFITEERING

When Congress offered George Washington a salary of \$500 per year, he refused to accept it and received no compensation other than his expenses. He believed that all patriots should be likewise willing to sacrifice for independence, called profiteers “murderers of our cause,” and was often appalled at what he described as the “insatiable thirst for riches which seems to have got the better of every other consideration.” Washington saw all speculators and profiteers as threats to the war effort and to America’s future as a country, but he was partic-

ularly critical of military officers who engaged in profiteering. Washington wrote that they were “lost to every sense of honor and virtue.”

Unlike the British and Hessian mercenaries, the American army consisted of volunteers who worked for little or no pay. Congress had decided in 1775 not to pay enlistment bonuses, but changed this in 1776. Four years later, troops were receiving \$150 for five months service. To increase their income, some soldiers deserted from one regiment to sign up with another, thus gaining an additional bonus. On learning of this practice, Washington established a punishment of 39 lashes, even greater than the 30 lashes that captured deserters received.

Washington allowed American troops to seize the property of captured British soldiers and divide it among the officers and men involved in the capture. He was determined, however, to stop what he called “unlawful plundering,” which he defined as seizing property that did not belong to the enemy troops. On one occasion, Washington ordered the death penalty for a soldier convicted of plundering. To reduce the plundering of locals, Washington restricted off-duty soldiers to their quarters and instituted roll calls. Both Washington and Congress approved of one method of privateering: the seizure of British ships docked in American ports. Records show that at least 800 British ships were seized; the American navy was responsible for the capture of 200 ships, and privateers seized the others.

Profiteering within the military covered many activities. It was not uncommon for supplies to be lost or stolen while being transported. Unpaid and discouraged troops who were being asked to fight with little or no food and inadequate clothing and shelter sometimes mutinied and stole from one another. To take advantage of the plight of American soldiers, the British promised generous compensation to Americans who joined their military. At times, the American soldiers deserted to take advantage of what the British offered, and then returned to their own armies well fed, well shod, and well equipped. American soldiers were also known to sell their services for the highest wages. In 1778, a newspaper in Wethersfield, Connecticut, openly advertised for “All gentlemen volunteers who are desirous of making their fortunes in eight weeks.”

Washington was determined that profiteers within the military would be severely punished. Records show that at least 30 officers were prose-

cuted for charges that included “writing fraudulent drafts on the commissary account,” defrauding troops of pay, overdrawing provisions, receiving fraudulent commissions, defrauding troops of blanket money, defrauding their own men, converting public property to private use, withholding pay from soldiers, misappropriating rum and soap, selling discharge papers, embezzling government funds and property, fraud, selling hospital supplies, forgery, and various other charges. Punishment for military profiteering included being forced to resign, making restitution, publishing details about crimes, and various criminal charges.

### GOVERNMENTAL PROFITEERING

Profiteers could also be found at the highest levels of government. So many government officials were suspected of profiting from secret deals with private contractors that Congress launched an investigation. Congressional investigators found that government profiteers frequently engaged in nepotism, favoritism, and other forms of corruption. For example, Samuel Chase attempted to establish a monopoly on flour, using information and contacts to whom he had access as a member of Congress. As a result of such practices, Chase’s home state of Maryland, and later Virginia, prohibited merchants from serving as their Congressional representatives. A number of procurement officers were believed to have used government purchasing as a cover for buying items that were then channeled into their own businesses where they were sold to supplement personal fortunes. These government profiteers were so unprincipled that they even used government ships and wagons to transport the merchandise to their own shops and warehouses.

Robert Morris, the chair of the Congressional committee responsible for finances and government procurement, was found to be a master profiteer. Even after the war, Morris continued his profiteering as the superintendent of finance. From this position of authority, Morris made sure that his exporting and importing business flourished. He handled government transactions through a bank he owned in Paris, France, and awarded government contracts to himself and his business partners. Whenever his businesses associates presented claims to the federal government, Morris paid them while denying valid claims from those outside his own circle. It is ironic that, in 1782, Morris was

given the responsibility for ferreting out “fraud, negligence, or waste on public property.”

Sometimes military profiteering was unintentional, as in the case of Nathanael Greene, who served as quartermaster general of the army. Greene was accused of profiteering because he was often forced to pay inflationary prices for goods that the American army needed. When necessary, Greene and a contractor signed a promissory note to pay for various products. Unfortunately, after the Revolution, the contractor filed for bankruptcy. Greene accepted responsibility for the loans and continued to pay on them until his death in 1786.

### PRIVATE SECTOR PROFITEERING

The most common form of private-sector profiteering was price gouging, which forced both the military and civilians to pay exorbitant fees for necessities and created enormous profits for merchants. Another method of profiteering was the creation of monopolies to corner specific products, and raise prices on those items ever higher than inflation demanded. Some manufacturers engaged in profiteering through cutting production costs and producing inferior goods unable to withstand military life. Inferior weapons, for instance, could cost a soldier his life.

The Revolutionary War also provided fertile ground for the speculators who bought shares in the ventures of profiteers. Prices on securities ranged from one-half to one-tenth of the face value. These shares were sometimes used as collateral by merchants, military officers, and even by government officials. It was estimated that by 1990, most existing securities belonged to speculators, with only a small amount remaining in the hands of pre-war owners. Harvard College, for instance, had amassed a total of \$102,923 in securities during the Revolutionary War, making the institution one of the largest security holders after the war. Harvard’s securities had been received from more than 80 sources. Speculators also made huge profits by trading paper money. In Boston, Massachusetts, for example, one so-called hard dollar could be traded for 75 paper dollars. Around the country, jobbers set up businesses to handle money exchanges.

Much Revolutionary-era profiteering arose from a scarcity of goods, because legal trade was restricted by the Non-Importation Agreements. Trade with the “enemy” was often quite open because a

number of the colonists maintained their allegiance to the British Crown. John Adams, the motivating force behind independence, estimated that only about one-third of the population was “vigorously” dedicated to the American cause.

Because England was so far away, merchants in the colonies prior to the Revolution had been somewhat free to establish their own prices and set their own rules. During the war, merchants resented government officials’ interference in their efforts to make money from the war. Disregarding the Non-Importation Agreements, many merchants continued to do business with England.

### BRITISH PROFITEERING

Like the Hessians, members of the British Army were often paid mercenaries who were willing to profit from the war in various ways. For example, a British lieutenant colonel who paid 4,500 pounds for his commission could become a paymaster and set up fraudulent pay systems that netted him thousands of pounds. As a sideline, the paymaster could purchase luxuries and sell them to regular soldiers at inflated prices. The British military also devised a way to charge the government for high-priced goods while purchasing low-quality goods and pocketing the difference. It was also common for British officers to draw rations for fictitious families, providing themselves with increased personal income. Hessian troops were notorious for plundering. They stole food, livestock, and property and often burned fences, trees, furniture, and buildings for firewood.

### THE STATES

When the Revolutionary War began in 1775, each colony had a separate government, and each was responsible to the British crown in some way. Once independence was declared, 13 separate governments operated in conjunction with a loose federal government. To deal with the emergency brought about by the war, individual states regulated essential or scarce items. Several states also published paper money and declared it legal tender, creating even greater economic problems. States made an effort to prohibit manipulation of monetary standards, but were not always successful.

Profiteering was such a problem that most states passed their own anti-profiteering laws. To

strengthen their positions, states sometimes joined to stop profiteering. For instance, in 1776, the New England states established price and wage controls. Violators were issued heavy fines, with 50 percent of each fine paid to the informer who reported the violation. Merchants all over New England reacted with outrage.

### SEE ALSO

war crimes; United States; embezzlement; price-fixing.

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## ancient mercantile crime

THE WELL-KNOWN IMAGE of Diogenes, a philosopher living in the 4th century B.C.E., swinging his lantern as he wanders through the streets of ancient Greece in a vain search for an honest man, vividly conveys the lesson that white-collar crime not only flourished in that culture at that time but, more generally, can be found to varying degrees in every large society throughout the history of humankind.

Diogenes’ own life underlines the point. His father, responsible for minting coins for public use, was convicted of adulterating the coins with base metals. Diogenes then left Sinope, the Greek shipping center on the Black Sea where he had been born, for Athens. He later settled in Corinth, where he preached against the accumulation of riches and luxurious living.

## CRIME IN THE ANCIENT WORLD

Marketplace offenses can be examined to support at least the partial truth of Diogenes' fruitless search for an honest person, a matter that can be examined by looking at efforts to keep impoverished people from starving to death. Rulers throughout history have tried to control monopolization and cheating in transactions involving food so that inadequate food supplies did not decimate or incapacitate the work force and lead the masses to riot in rebellion against the rich and against the political leaders.

In ancient Egypt, near the end of the 7th century B.C.E., poor harvests led to Solon forbidding the export of agricultural products, with the exception of olive oil, a move taken because unscrupulous landowners were sending grain abroad in order to realize greater profits.

Centuries later, in 476 B.C.E. on the island of Teos, a Greek port on the west coast of Asia Minor, a "curse" was decreed by public officials on marketplace malefactors. It was to be read three times a year at public events: "If anyone prevents grains from being imported into the land of Teos by any pretext or device, either by sea or from the mainland, or forces up the price of imported grain, that man shall die, both himself and his family."

The Greek Appolonius is said to have come to the city of Aspendus where he found the people eating weeds in order to stay alive. A mob was on the verge of burning the governor alive, until he disclosed the names of those who were hoarding corn. These merchants were summoned and the governor read to them a message composed by Appolonius, who had vowed to remain silent for five years: "The earth is mother of all, because she is just," Appolonius had written. "But you are unjust and have pretended that she is your mother alone; and if you do not stop I will not permit you to remain on her." The hoarders were said to have been so terrified by these words that they filled the marketplace with corn and the city revived.

In ancient Greece, the law decreed a penalty of death for exporting corn or secreting or hoarding it. Peter Gurney notes that scarcity was sometimes relieved by charitable food contributions by the well-to-do. He maintains that the typical donors were two-faced, looking for both financial profit and popular gratitude. Importantly, he notes, "in antiquity, food was power."

Fiery complaints about marketplace cheaters are a common theme in Judeo-Christian theology. A biblical prophet, Micah of Moresheth, condemned all commercial activity of the time as likely to be sinful: "A merchant shall hardly keep himself from doing wrong and a huckster shall not be freed from sin," Micah wrote. "As a nail sticketh between the joinings of a stone, so doth sin stick close to buying and selling." Talmudic law echoes this position: For commodities deemed necessary to life such as wines, oils, and various types of flour, the rabbis forbade a person to make a profit as a middleman. These essential goods were to be sold directly to the consumer in order to keep the prices low. The Talmud also berated those who tampered with weights and measures and raised prices unjustly. In Proverbs (11:26) in the King James Bible there is the admonition: "He that withholdeth corn, the people will curse him: but blessing shall be upon the head of him that selleth it."

Marketplace offenses tended to be peripheral in Roman life because from the time of Tiberius (11–37 C.E.) to Aurelian (270–75) grain was distributed without cost to upward of 100,000 persons by the Emperor. Later Roman law decreed that *dardanarii*, the term for persons who conspired to increase their profits by delaying deliveries by sea or by employing similar tactics to demand exorbitant prices, were to be punished by a heavy fine, prohibition of future trading, or banishment. Specific laws focused on the magistrates whose duty it was to supervise the importation and local sale of food, with women and slaves encouraged to provide evidence against magistrates if they neglected their tasks.

## CRIME IN EARLY ENGLAND

Religious leaders in England later would repeat the Biblical condemnations of commercial cheating. John Bunyan, the author of *Pilgrim's Progress* (1678), at one time the bestselling book after the Bible, rages against "every man that makes a prey of his advantage upon his neighbor's necessities may well be called an extortioner and judged for one that hath no inheritance in the Kingdom of God." Such persons, Bunyan declared, should "be hissed out of the world."

An interesting sidelight on these views is offered by Thomas Aquinas (1225–74), the leading interpreter of Catholic theology. Aquinas retold the centuries-old observation of Cicero, the Roman or-

ator, about a merchant who was carrying grain to the starving people of a town stricken by famine. The merchant knew that others were following him with more grain. Was he bound to tell the townspeople about the additional grain, or might he remain silent and command a higher price? Cicero had concluded that moral duty demanded disclosure. Aquinas, however, indicated that it would be commendable to tell what the merchant knew, but he maintained that the merchant was not obligated by moral law to predict a future event.

If it failed to occur, he would be robbed of a just price. Today, in the United States, those associated with businesses under the eye of the federal Securities and Exchange Commission are obligated by law to let the public in on relevant information that might influence what investment decisions people make, and to avoid insider trading.



*The distribution of bread, to forestall public revolt, became a foundation of government regulation of trade.*

In England at the time of the invasions of the Saxons and the Danes, the law demanded that anybody who transacted business with a merchant at the market had to provide the authorities with the details of the business and bring a witness to testify to what had transpired. By the time of Athelstan in about 930, all sales involving more than 20 pence had to be conducted publicly. Similar attempts to keep traders honest followed. Aethelred, king of England from 978 to 1016, decreed that purchasers of cattle or sheep must preserve the head and hide for three days before they could sell the carcasses. Under King Canute, a Dane who conquered parts of England in 1013 and married Aethelred's widow, a similar provision to retain proof of a transaction was mandated if more than 4 pence was involved, unless the purchaser had four witnesses to the transaction.

## REGULATED MARKETS

Trading at this time became restricted to specified places and times. This introduction of regulated markets and fairs, the latter generally held but once a year, the former every week, allowed tighter control over commercial ventures. It has been estimated that between 1200 and 1340 thousands of licenses were issued by government authorities to persons seeking to inaugurate markets and reap the gain from the rental of stalls to those with goods to sell.

English common law was defined by William Illingworth, writing in 1800, as "no other than the good old laws and customs handed down to us by our ancestors." Under common law, three specific marketplace offenses were prohibited. They were called forestalling, engrossing, and regrating. All essentially involved tactics that took advantage of a monopoly position to exploit consumers; their offenses are the direct forerunners of current antitrust legislation.

Forestalling referred to the buying up of goods before they reached the market with a view to enhance prices by cornering the market. Engrossing involved wholesale purchasing, that is, the buying of the total quantity of goods available and then demanding whatever price the seller can obtain. Regrating dealt with the purchase of commodities at one market with the intent to sell them at another site where, for whatever reason, they would retail for a higher price.

Parliamentary and law-enforcement attention focused on these offenses particularly when there were food shortages and, in dire instances, famines and starvation. The first known Parliamentary enactment on the subject came in 1266 when the common law was codified by statute and tougher penalties were set in place. One possible sentence for forestalling involved having the offender stand in the pillory (called, more informally, the stretch-neck) with his head and ankles pushed through holes and shackled. Culprits often would be mocked by passersby throwing rubbish at them.

It is worth noting that the 1266 parliament that enacted the initial statutes against forestalling, engrossing, and regrating for the first time (and for centuries, the last time) had women among its members. They were the widows of earls and barons who had been killed in the incessant wars waged in medieval times. Numerous later statutes amended the laws against forestalling, engrossing, and regrating. In 1306, those who violated such laws were reviled by Parliament as “oppressors of the poor” and the “public enemy of the country, a canker, a moth, and a gnawing worm which daily wasteth the commonwealth.” One has to wonder whether the absence of such language in our times regarding some white-collar crimes is a victory for gentility or a loss of moral indignation.

The landmark statute against marketplace offenses was put in place in 1552. The law sought to gather together common-law provisions and to update and make more rational the approach to violations of rules regulating marketplace behavior. Considerable subsequent litigation required the English courts to clarify the reach of the 1552 law. Much of it reflected what we now regard as quaint quibbling characteristic of court proceedings at the time. Among matters that the courts had to adjudicate in earlier times was the question of whether an indictment was satisfactory if it used the Latin term *cumulus* (a heap) rather than specifying precisely what amount of grain was involved in the allegedly illegal transaction. Courts ruled that buying grain with the intent to make starch out of it did not violate the statute because the end product was not the same as the original one, or, as the court put it, the corn “is altered by a trade or science, which is a mystery, and so it is not the same thing that was sold.”

Controversy also arose regarding whether salt did or did not come under the law. At the same

time, English courts were subtly undermining the forestalling laws because of judges’ belief in the benefits of free trade as opposed to marketplace regulation. The eminently powerful Chief Justice Sir Edward Coke (1552–1634), in his treatise on English law, is said by a later historian to have shown “a certain amount of what only can be described as propaganda against control.”

## GROWTH IN TRADE AND POPULATION

The gradual weakening of the laws against forestalling are traced by one scholar to a number of developments: Partly as a result of economic expansion, but still more because of the much larger growth in the provincial population, there was a great development of inland trade in England between 1570 and 1640. The open markets of provincial towns gradually proved incapable of accommodating the expanding demand. By 1640, much of the new trade was transacted outside the “official market,” and was unregulated by local officials. It took place, instead, in the warehouses and, above all, in the inns of provincial towns.

Nonetheless, in periods of severe food shortages, authorities emphasized the necessity to enforce ancient marketplace regulations. For the authorities, dearth was caused not by divine displeasure nor by unfavorable weather but by human greed. In 1597, the Privy Council, on behalf of the king, issued a strong indictment of marketplace manipulation:

There are seene and fownde a number of wycked people in condicions more lyke to wolves or cormorants then to naustrall men, that doe moste covetously seeke to holde up the late great pryce of corn and all other victuells by ingrossing the same into their private hands berganynge beforehand for corne, and in some parts for grayne growing and for butter and cheese before yt be brought to ordynarie marketes for to be brought for the poorer sorte. Against which fowle, corrupt fraude and malicious greedyness there are both manie good lawes and sondry orders of late yeres given to all Justices.

Under Oliver Cromwell, after King Charles I had been put to death, *habeas corpus* and writs of *certiorari*—legal processes that afforded protection to the



accused—no longer were permitted for offenses that involved buying and selling of a large variety of products because, it was claimed, “the punishment of many abuses wee daily prevented and discouraged by such writs.”

A century later, circumstances had changed in dramatic fashion. In 1767, a Parliamentary committee concluded that the laws relating to forestalling were preventing the free trade in grain and other provisions and that this, rather than hoarding and monopolies, was contributing to the excessive price rises. In 1773, Parliament eliminated all statutes that prohibited forestalling, engrossing, and regrating. The common law restrictions remained in place until 1844, though they were rarely enforced.

Adam Smith (1723–1790), one of the leading economists of his and all time, led the charge against the ancient marketing laws. In his monumental treatise, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), Smith called the regulations “altogether unmerited” and that, left to its own devices, the marketplace will assure that fairness will prevail. High prices, Smith proclaimed, will merely put “the inferior ranks of people upon thrift and good management” and by this means “the dreadful horrors of famine will not ensue.” In a famous line, Smith compared “the popular fear of forestalling” to “suspicion of witchcraft.”

Smith’s views did not impress Jeremy Bentham (1748–1832), another famous political philosopher. For Bentham, the government deservedly ought to seek to regulate social conditions to see that justice prevailed. “I leave it to Adam Smith to talk of invasions of natural liberty,” Bentham wrote. “The interference of government is an event I witness with satisfaction and with much more than I should its forbearance.”

The last throes of the crime of forestalling saw the conviction in 1795 of John Rusby, a middleman. Rusby was indicted for regrating on the basis that he had re-sold oats in the same market on the same day. He was tried before Lord Kenyon who summed up the case in ringing terms, emphasizing the damage done to the poor and starving by such underhand marketplace tactics. Kenyon declared that if Smith were still alive he was certain he would change his views about eliminating the crime of forestalling.

Kenyon told the jury that its verdict would “stem the torrent of such affliction to the poor.”

The jury found Rusby guilty and the judge imposed a stiff fine.

Worse was yet to come. Rusby’s house was torn down by an angered mob that subsequently descended on the market and demanded that prices be lowered. The rioting drove many merchants out of the marketplace, thereby causing a further increase in prices.

## CRIME IN THE AMERICAN COLONIES

The legislative history of the American colonies shows the adoption of laws against forestalling because of ties of the colonists to English law. Most of these laws came into force about the time of the American Revolution, when England was backing away from legal control over marketplace middlemen. It had been proposed (and opposed) during the Continental Congress in 1777 that federal laws be adopted to outlaw forestalling and engrossing. In June 1777, Maryland forbade forestalling if the price involved provided the seller a profit greater than 30 percent. Sir Henry Clinton, governor of New York, issued a proclamation late in 1777 that declared if a person sold goods for a price higher than that stipulated by the authorities, his merchandise would be seized and he could be imprisoned. Connecticut outlawed engrossing in the same year, with a particular focus on salt.

Officials were authorized to seize goods being engrossed and sell them at prices set by colonial officials. Similar kinds of enactments were made in the same year in New Jersey, North Carolina, and Pennsylvania. But, as in England, the ideas of free trade, a self-regulating marketplace, and the importance of middlemen to spare growers extra work carried the day.

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American Revolution; United Kingdom; free trade; capitalism.

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## Anderson, Jack (1922– )

JACK ANDERSON IS a Pulitzer Prize-winning investigative reporter, author, and public speaker. A former missionary, Anderson's career as an investigative reporter began in the early 1950s when he teamed with the most famous muckraking journalist of his day, Drew Pearson.

Anderson's most notable encounter with white-collar crime took place during the Watergate era (1972–74). Anderson had reported on several scandals involving President Richard Nixon, which landed Anderson at the top of Nixon's infamous Enemies List. As a result, a plan emerged by the Plumbers (a secret covert-operations unit within the White House) to have Anderson murdered. Gordon Liddy, the Plumbers' chief fanatic, finally backed-off of the plan to assassinate Anderson because it was deemed impractical.

Upon taking office, the Nixon administration dispatched an allegedly Mafia-connected attorney, Murray Chotiner, to see visit Anderson. The lawyer informed Anderson of the administration's wish to have a friendly relationship with him, and that Chotiner had been appointed liaison to Anderson. At Anderson's request, and as a show of "friendliness" to help further Anderson's investigations, Chotiner promptly fetched the Internal Revenue Service (IRS) file on Governor George Wallace of Alabama. It contained information on a Wallace crony who was taking kickbacks on sales on alcohol in state liquor stores, and laundering cash through a law firm in which Wallace was a partner. Anderson made use of the information, but also began writing pieces critical of the Nixon crowd, and the Nixon administration "friendship" was promptly withdrawn.

Anderson soon began uncovering a host of scandals that would come to mark the Nixon administration as one of the most corrupt in Ameri-

can history. It began when Anderson discovered that Nixon was trying to get his presidential pension increased. Anderson also discovered, via secret papers that were leaked to him, that Nixon had ordered a U.S. Navy flotilla to the Bay of Bengal in order to support Pakistan in its war against India. This, despite Nixon's sworn neutrality in the conflict.

Nixon had deceived the American people about U.S. neutrality in the war, as well as a possible confrontation with the Soviet Navy in the Indian Ocean. The White House began investigating Anderson and his possible sources of information (via phone taps, lie detector tests, and in some cases, intimidation). Press attacks against Anderson ensued. Meanwhile, Anderson was awarded the 1972 Pulitzer Prize for his coverage of the India-Pakistan War. Shortly thereafter, Anderson came into possession of memo written by International Telephone and Telegraph (ITT) corporate lobbyist Dita Beard. The memo made clear that ITT was about to donate \$400,000 in support of the upcoming Republican National Convention in San Diego, California, in return for which the Nixon Justice Department would allow ITT to keep two newly purchased companies, Hartford Insurance and Grinnell Corporation. The Senate Judiciary Committee called immediate hearings on the matter. ITT hired a detective firm to investigate Anderson.

Despite the decision not to eliminate Anderson, the Nixon White House used other government agencies to harass Anderson. At the White House's request, the IRS audited Anderson's income taxes for months but found nothing irregular. The Central Intelligence Agency followed Anderson all over Washington in unmarked cars, but Anderson easily detected their presence and wrote about the stalking.

Nixon, for 25 years, had a great dislike and fear of what he regarded as the "eastern liberal establishment press." The animosity between Nixon and the press began during Nixon's initial campaigns for the House of Representatives and the U.S. Senate. His virulent anti-communist campaigns against his opponents, Helen Douglas, whom he dubbed "the Pink Lady" (labeling her a socialist), and Jerry Voorhees (whom Nixon labeled a communist), outraged numerous reporters. So did Nixon's participation in the anti-communist, Senator Joseph McCarthy's House Un-American Activities Committee of the 1950s in which Nixon played a key

role in the convictions of Alger Hiss and Julius and Ethel Rosenberg on charges of spying for the Soviet Union. Anderson and his partner at the time, Pearson, were instrumental in attacking the unconstitutional investigative tactics of McCarthy.

Anderson continued his involvement in investigative reporting throughout a career that spans over half a century. In his eighties in 2003, he was reporting on the Blackout of 2003 during which a cascading power failure knocked out the electrical grid though Canada and the U.S. Northeast.

#### SEE ALSO

Nixon, Richard; Watergate; International Telephone & Telegraph (ITT).

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## Anheuser-Busch

THE INTERNATIONAL brewery's 1997 removal of a Florida distributorship from the family of baseball legend Roger Maris became a \$72.6 million embarrassment. The distributorship, which served the Gainesville-Ocala area, was given to Maris's by August Busch, Jr., as a reward for Maris's role in the St. Louis Cardinals's 1967 World Series victory. Busch then owned both the baseball team and the St. Louis-based brewery.

In the mid-1990s, Anheuser-Busch started consolidating wholesalers into larger regions. The company offered the Maris family \$20 million for Maris Distributing. When the offer was refused, Anheuser-Busch terminated the wholesaler's contract, alleging that the Marises had sold outdated beer and failed to respond to customer complaints. The Marises accused the brewer of engaging in a smear campaign to justify its giving the distributorship to a Busch family friend.

The Marises also argued, unsuccessfully, that a contract provision preventing them from selling to public investors violated antitrust laws. Although

the antitrust charges failed, a Florida jury decided in August 2001 that Busch had lacked adequate grounds to terminate the distributorship. The jury awarded the Marises \$50 million for the value of the business plus \$89.7 million for lost revenues. Judge Buzzy Green voided the larger award, citing Florida statutes against awarding lost revenues, though he added accrued interest to the \$50 million.

Anheuser-Busch's 2002 annual report stated that the company appealed the decision and had not paid the \$72.6 million recorded in October 2001. The Marises also filed a \$1 billion defamation suit against the brewery; this remains unresolved in early 2004. "It sends a warning signal to suppliers to change the way they rank and yank their distributors," Mark H. Rodman, former general counsel to the National Beer Wholesalers Association, told the St. Louis Post-Dispatch after the August 2001 verdict. But, Rodman cautioned, "Very few legal teams can go toe-to-toe against A-B."

#### SEE ALSO

antitrust; Sherman Antitrust Act.

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## antitrust

IN GENERAL, antitrust refers to the regulation of business practices that significantly reduce or deny competition and/or severely limit consumer access to goods or services at reasonable and competitive prices. In this respect, the purpose of antitrust laws is to criminalize and breakup monopolies, protect against unfair competition, and control mergers. The development of antitrust legislation began

shortly after the Civil War as political legislators became increasingly skeptical of the growing power and size of business organizations.

From 1887 to 1904, several mergers took place that effectively established dominant monopolies including Standard Oil in the petroleum industry, U.S. Steel, American Tobacco, Kodak in the camera and film industry, and DuPont in the explosives industry. The development of these cartels posed serious concerns about their potential to control the U.S. economy. The threat of monopolistic practices meant a single firm in a market could effectively reduce output, control market prices, and earn higher profits in the absence of competition. Furthermore, the existence of monopolies could make entrance into the market by new competitors extremely difficult. Legislators were also worried about the welfare of small businesses under such conditions. In particular, there were concerns that small businesses would not be able to remain competitive if they encountered predatory or discriminatory low prices set by large companies.

## ANTITRUST ACTS

To address concerns of the growing number of monopolies, the federal government developed the Sherman Antitrust Act in 1890. This act became the primary legislation to address concerns of unfair competition and market conditions. The Sherman Act is comprised of two primary sections. Section 1 addresses any actions intended to produce an unreasonable restraint of trade or commerce. Specifically, this section prohibits contracts, combinations, and conspiracies that attempt to restrain trade efforts.

Section 2 of the Sherman Act deals with the issue of monopolies. It states that any person or persons who attempt or conspire to monopolize an industry is in violation of the act. Other provisions within the Sherman Act pertain to criminal sanctions. More specifically, the act allows the federal government to seek criminal and civil remedies against companies and subjects violators to potential fines or imprisonment. Private citizens injured by monopolistic practices can also seek damages.

Shortly after the development of the Sherman Act, Congress passed other legislation to deal with unfair market practices. It should be noted that about 10 of the first 15 antitrust cases were brought against labor unions and organizers, accusing them

of using labor strikes and boycotts as restraints of trade.

In 1914, the Clayton Act and the Federal Trade Commission Act were passed. The Clayton Act focuses primarily on the development of mergers. This act suggests that mergers necessarily increase concentration and encourage coordinated activity among a few companies. The existence of such mergers means that a relatively small number of companies can control prices, market conditions, and effectively reduce competition.

In 1968, the Clayton Act served as the basis for the development of the Merger Guidelines drafted by the Department of Justice's Antitrust Division. The guidelines outline the conditions under which mergers would likely be challenged and considered a violation. The Federal Trade Commission Act was designed to punish any unfair methods of competition. In particular, this act made it unlawful to restrict competition using unfair trade practices.

Enforcement of antitrust laws were relatively weak. From 1890 to 1899, only 15 cases were filed by the U.S. Department of Justice under the Sherman Act. Loopholes and ambiguous language also rendered the Sherman Act ineffective in terms of dramatically limiting the existence of monopolistic practices. In an 1895 decision, the Supreme Court ruled that manufacturing companies, such as American Sugar Refining Company, could not violate provisions stipulated by the Sherman Act since manufacturing was not interstate commerce.

Perhaps the most aggressive enforcement of the Sherman Act came after World War II. Between 1940 and 1959, there were a total of 703 cases filed by the Justice Department compared to only 203 cases from 1890 through 1939. Also during this time, the number of private suits under the Sherman Act began to increase. During the 1950s and 1960s, several Supreme Court decisions prohibited mergers between firms if at least one of the companies had a modest market share. The rationale behind such decisions was to ensure competition and preserve market structures within the American business community.

Despite the more assertive efforts, by the early 1980s, the Ronald Reagan administration relaxed government involvement in antitrust matters. Court decisions during this time rarely prohibited mergers or price-fixing practices. Even in cases where mergers eliminated potential competitors,

the courts were reluctant to aggressively enforce antitrust laws. This *laissez-faire* (hands off) approach meant that companies were allowed to establish mergers and monopolies without penalty. There was also reluctance to award damages in private suits. Also, an influential economic perspective emerged that suggested mergers and monopolies were actually pro-competitive rather than anti-competitive. Economists from the Chicago School maintained that price-fixing or other antitrust practices cannot be readily accomplished because market conditions do not allow them, and that it was fairly easy for new companies to enter an industry.

Recent decisions have tended to reflect this viewpoint as courts have ruled the presence of mergers, oligopolies, or even monopolies does not necessarily indicate unfair market conditions. In one of the more celebrated exceptions to lenient enforcement of antitrust laws, in 1998 the United States filed charges against the computer software giant, Microsoft, for violations of the Sherman Antitrust Act. A 2001 court decision found Microsoft guilty of violating Sections 2 of the Sherman Act. In particular, the court found that company unlawfully had power in the market for licensing Intel-compatible PC operating systems.

#### SEE ALSO

Sherman Antitrust Act; Clayton Act; Federal Trade Commission Act; Microsoft; Standard Oil.

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## Arab nations

DEVELOPING countries, such as those of the Arab world, are particularly vulnerable to both organized and business crime because of political,

legal, and economic systems that are still in the process of evolving. Just as in the rest of the world, most economic crimes in the Arab world stem from corrupt government officials, an avaricious business community, and individuals and groups who are willing to exploit others to achieve their own goals.

The United Nations Office on Drugs and Crimes has observed that corrupt governmental authorities in many developing countries regularly force residents to pay “surcharges” to obtain drivers’ licenses, building permits, or other routine activities. Representatives of the World Bank have stated that corruption is the single greatest obstacle to economic and social development in the world today. Widespread corruption tends to sap the energies of any country, and the resulting anger and cynicism affect the level of trust that is necessary for political and economic systems to function effectively. Corruption also drains the economic and human resources that are vital to developing nations.

Developing countries generally lag behind on technological advances, and computer crime has presented a new and complex problem for Arab countries. Many Arab nations have set up special e-crime units to deal with incidences of cyber crime. While computer hacking in the Middle East amounts to only 1 percent of the world’s hacking totals, incidents of cyber crime are on the rise. For example, in 2002, the United Arab Emirates saw a 300 percent rise in computer hacking in only six months.

In a major crime spree, which UAE traced to Indonesia, hackers managed to steal between \$2 and \$3 billion in an ATM (auto-teller) scam. This incident helped to alert Arab countries to their vulnerabilities. Experts on cyber crime have determined that Iran, Kuwait, United Arab Emirates, Saudi Arabia, and Egypt are among the top 10 nations of the world that are the most vulnerable to attack by computer hackers.

## GOVERNMENT AND BUSINESS

In addition to business and organized crime, the Arab world has had its share of political scandals. In Israel, for example, the police interrogated Prime Minister Ariel Sharon in November 2003 about a \$1.5 million loan from a South African businessman. A separate scandal involved Sharon’s son,

Gilad, who exercised his right to remain silent when questioned about a suspiciously illegal development deal in Greece. In November 2003, the Muslim Brotherhood charged the administration of President Hosni Mubarak of Egypt with providing cover for widespread corruption at all levels of government. For over six decades, governmental authorities in Lebanon have been unable to stop widespread corruption. In 2003, several major scandals occurred. Lebanese officials launched an investigation concerning questionable activities at the Al-Madina Bank. Central Bank Governor Riad Salameh filed charges against unknown individuals who had forged his signature on two documents, one of which approved a merger and another dealing with a \$170 million transfer of funds. Other high-profile scandals involved a prominent businessman who passed a fraudulent check for \$100,000 and shady real estate deals.

Jordan focused international attention in 2003 on the case of financier Ahmad Chalabi who had been appointed to the Iraqi Interim Governing Council even though he had been convicted in Jordan *in absentia* on charges that he stole more than \$500 million during the Petra Bank scandal of the 1980s. Jordanian officials accused Chalabi of engineering fraudulent financial deals that involved Iraq, Iran, Lebanon, and Switzerland. Chalabi's brothers Jawad and Hazem were convicted of accounting fraud in Switzerland in 1989. Jordan announced that it had passed a new law that would allow Chalabi to repay the money he stole in return for an official pardon; however, authorities believed that the United States would prevent Chalabi from being extradited to Jordan.

Business crime is also a major concern to the Saudi authorities. In 2002, the Saudi government announced that it had documented 264 cases of bribery involving 747 individuals.

In the United Arab Emirates (UAE), business crime has centered on embezzlement of funds, fraud, and bribery. In the winter of 2001, a major scandal erupted when 20 UAE government officials were charged with corruption and embezzlement. In response, the minister of justice and Islamic affairs asked the public to demand that government corruption, that had long been a part of life in the United Arab Emirates, be brought to a halt.

In addition to economic crimes, the Arab world has proved fertile ground for organized crime. Crimes practiced by these groups include: terror-

ism, money-laundering, drug trafficking, arms trafficking, human trafficking, explosives, business fraud, insurance fraud, government fraud, computer crimes, extortion, bribery, murder, theft of art and cultural objects, and kidnapping. In fact, kidnapping has become so common in Arab countries that a number of insurance companies, including Lloyds of London and Liberty Mutual, regularly issue kidnapping insurance that pays up to \$40 million if a policyholder is kidnapped or becomes a victim of extortion.

Traditionally, organized crime is driven in large part by a desire for financial gain and is characterized by violence and intimidation. Organized crime families tend to be made up of individuals who share common goals who bond together under strict rules of loyalty and compliance. Disloyalty to the group may be punishable by death. In the Arab world, the basic human greed common to participants in organized families is both enhanced and complicated by radical political beliefs and religious fundamentalism. Organized crime groups that start out with political or religious goals may become so focused on furthering economic goals that their original purpose becomes secondary. In some Arab countries, the state becomes the instrument of international terrorism.

Beginning in the mid-1980s, leaders of some Arab states sponsored the targeting of American military and diplomatic targets throughout the Middle East. In other Arab states, the state engaged in Mafia-like tactics of terrorizing the locals through violence, threats, extortion, and bribery. In Saddam Hussein's Iraq, for example, he and his relatives were joined by an army of state police in their campaign to intimidate the Iraqi people. In many Arab countries, the legal system has proved ineffective in combating organized crime, and this is particularly true when the government is involved in criminal activity.

Despite the U.S. invasion in November 2001, a well-supported organized crime network in Afghanistan continues to be involved with drug trafficking, particularly with opium, and the trafficking of women. An additional enterprise includes the practice of trading emeralds that originate in the Panjshir Valley, that are purchased duty-free in Oubai, and then smuggled into Pakistan, India, and other parts of the world.

Organized crime in Egypt has placed the country in the position of becoming a transit point for

heroin and opium that is smuggled out of Asia into Europe, Africa, and the United States. Because of the drugs, money-laundering is a major criminal activity in Egypt. In many Arab countries, organized crime often becomes entangled with religion. In Egypt, for instance, the Muslim Brotherhood has consistently tried to force the Christian Copts to pay a tribute or *gizia*, which they claim is a kind of protective tax.

The Israeli police announced in 2003 that organized crime, including drug smuggling and human trafficking, was on the rise. Government investigations also focused on questionable ties between Israeli and Palestinian businessmen. A number of criminal charges were filed in Palestine in the summer of 2000 arising from the counterfeiting activities of several gangs. Investigations revealed that Israeli and Palestinian manufacturers were heavily involved in counterfeiting compact discs, computer software, name-brand jeans, liquor, packaged foods, and perfume. A car ring was also discovered in which Palestinians stole cars in Israel, stripped them down, and then sold the parts back to Israelis. In 1997 alone, 46,000 cars were stolen from Israel, amounting to one-third of all new cars sold that year.

Insurance fraud also surfaced when Israeli citizens were accused of selling cars to Palestinians who then sold them for inflated prices while the original owners filed insurance claims for stolen cars. Tens of thousands of guns are stolen from Israeli homes each year, and many make their way into the hands of Palestinians or various terrorist groups. In addition to drug trafficking, the manufacture of counterfeit drugs also poses major problems in both Israel and Palestine.

In Saudi Arabia, authorities have become so determined to stamp out the illegal drug trade that they have made drug trafficking a capital offense. The country also has a problem with money-laundering used to cover the tracks of drug dealers and other criminals. Saudi authorities acknowledge that the country has also become a transit center for organized arms smuggling. Because of its vulnerability to organized crime, the Saudis, working with United Nations representatives, have developed legislation aimed at eradicating organized crime. Saudi Arabia took the lead among Arab nations in establishing a multi-level anti-organized crime program that included establishing a nationwide standing committee to research and report on organized

crime, creating a department of public security that specialized in the subject, training the criminal justice system to deal with the problems associated with this type of crime.

The UAE has also taken a leadership role in combating organized crime. Working with representatives from the United Nations, the country sponsored a two-day conference in December 2002 to bring together representatives from other Arab countries to examine the impact of world political, economical, and technological developments and their impact on organized crime in an international context. Because of its status as a financial center, UAE has had to cope with extensive money-laundering. In January 2002, new legislation was passed to deal with the problem. Just as in most other countries of the world today, drugs are also a major source of crime within UAE.

## TRANSNATIONAL CRIME

Organized crime has become an international problem because crime "families" regularly cross their own national borders to wreck havoc on the rest of the world. The problems arising from transnational crimes have become so extensive that the United Nations has developed special programs directed toward eradicating transnational crime. These programs have two major goals: helping individual nations to develop policies and laws to deal with such criminal activity within each country, and fostering international cooperation through enhanced intelligence and sharing of information. Arab countries, often working with the United Nations, are banding together to fight organized crime by treating it as a regional and international issue as well as a domestic problem. Terrorism, arms smuggling, drug trafficking, and money-laundering have surfaced as the predominant transnational crimes.

A September 2003 report issued by the Executive Director of the Algerian branch of Interpol warned that he had established a definite link between terrorist groups and the organized crime activities of the GIA Armed Islamic Group, the GSPC Salafist Group, and al-Qaeda that stretched into parts of Africa, Asia, and the West. These groups used charity groups as fronts to raise money to set up training camps for terrorists and to purchase illegal weapons from other nations.

The International Anti-Counterfeiting Coalition (IACC) has also identified a growing problem

with transnational counterfeiting that costs over \$200 billion a year from lost jobs, taxes, and profits. The counterfeited items, many of which originate in Arab countries, include name-brand clothes and shoes, compact discs, perfume, liquor, and a host of other products. IACC has also identified links between organized counterfeiting rings and various terrorist organizations. In addition to the traditional understanding of terrorism, a new element has been added with the introduction of "narco-terrorism," which uses drug trafficking to achieve terrorist goals.

Organized crime from Arab countries has taken root in other countries around the world through emigration. For instance, a well-known Iraqi crime group known as the Chaldean Mafia began operating in the United States during the latter half of the 20th century. The group, based largely in Detroit, Michigan, and Chicago, Illinois, has been suspected of drug trafficking, gambling, and the smuggling of illegal immigrants. The Chaldean Mafia, which has around 150,000 members in the United States and over 600,000 in Iraq, is reportedly controlled by Bahaa Kalscho from a Michigan jail cell.

Unlike the Chaldean Mafia, the Arabian Posse originated in the United States in response to anti-Arab attacks in Chicago during the Gulf War in 1991. In Roanoke, Virginia, the Abed Crime Family was accused of attempted contract killing, arson-for-hire, drug dealing, witness intimidation, and extortion. Organized crime rings regularly smuggle drugs into the United States from Arab countries.

For example, an Israeli crime syndicate has become the foremost provider of the drug known as Ecstasy. The United States is not the only nation to have been infiltrated with Arab crime gangs. South Africa, for example, has been overrun with more than 230 Pakistani crime groups that use local South African criminals to smuggle diamonds and other precious jewels, and to engage in illegal drug trafficking.

#### SEE ALSO

bribery; public corruption; corruption; charity fraud; organized crime; drug trafficking; human trafficking; money laundering.

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## arbitrage

A SIMPLE definition of arbitrage comes from Investorwords.com: "Attempting to profit by exploiting price differences of identical or similar financial instruments, on different markets or in different forms."

Arbitrage is possible because markets are driven by imperfect information. It is therefore possible for the same security to have one value in New York and a slightly different value in London. When dealing with large amounts of securities, a difference of a fraction of a cent can yield substantial profits for the clever arbitrageur.

The classic, almost risk-free form of arbitrage is taking advantage of small differences in the pricing of foreign currencies. Let's say that one dollar in United States currency is considered equivalent, today, to 0.85 euros. One euro is trading for 260 Hungarian forints. And one Hungarian forint is trading for 0.00475 U.S. dollars. A currency arbitrageur could buy dollars in the United States, convert them to euros, then to forints, and finally back to dollars in the United States, pocketing a profit.





*Speculating on the different prices of world currencies at a given point in time in several different locations is one form of arbitrage. Arbitrageurs can yield great profits from small currency fluctuations.*

trageur with \$100 buys 85 euros. She then trades her 85 euros for 22,100 Hungarian forints. Finally, she trades her 22,100 Hungarian forints for \$105. Based on a small mismatch in currency values, she has made a 5 percent profit.

However, our arbitrageur probably will not be able to make the same maneuvers tomorrow, as her own actions are part of the market. As other traders see and respond to her trades, the values of the three currencies will tend to adjust into closer parity. At some point, the small differences in value will become smaller than the costs of the transaction, removing the opportunities for arbitrage.

This basic example points to the value and perils of more complex forms of arbitrage. Arbitrage is valuable to markets because it gradually adjusts mismatches in value, creating a more rational market. At the same time, arbitrage opportunities are few, difficult to identify, rarely greater than their own transaction costs, and tend to eliminate themselves through their own effectiveness. Successful arbitrage in more complex securities markets can be a difficult investment strategy to pursue without illegal insider information.

### THE BOESKY WAY

Ivan Boesky's manual on arbitrage techniques, written before his arrest and conviction for insider trading, touts risk arbitrage as a "sensible investment strategy." Risk arbitrage differs from classic arbitrage in that its currency is not money but securi-

ties. For Boesky and his imitators, opportunities for risk arbitrage were the low-hanging fruit of corporate mergers.

As Boesky explains, in the simplest merger, a stock-for-stock exchange, the acquiring company often bids more for the target than its current stock price. So, for instance, General Electric, now trading at \$28 a share, offers to buy Terra Networks, now trading at \$5.75 a share. In a perfectly even trade, each GE share is worth 4.87 shares of Terra Networks. However, GE wants Terra's shareholders to approve the merger. Therefore GE offers a 1:4 swap, treating Terra shares as if they're worth \$7 each.

This means that today, Terra stock is worth \$5.75, but the day of the merger—if the merger happens—Terra stock will be worth \$7. The arbitrageur sees an opportunity for a profit of \$1.25 a share, the difference between \$5.75 and \$7. His plan is to buy Terra now at \$5.75 and sell it after the merger for \$7. Ordinarily, GE will be pleased to see arbitrageurs buy Terra stock, as the arbitrageurs want the merger to happen and will vote their stock accordingly. (GE will become less pleased if arbitrageurs generate so much activity that Terra stock rises above \$7 and GE has to pay more to acquire the company.)

Boesky adds that an arbitrageur would also usually protect himself from the danger of a fall in GE's stock price by selling short the stock of the acquiring company. In effect, he would borrow and sell shares he doesn't have at today's \$28 price, knowing that if GE's value falls, he can buy its stock

at the new, lower value to cover the stock he sold at the old, higher value. If this hedging is done correctly, it will lock in a reliable profit for the arbitrageur.

Most mergers and acquisitions are not, of course, simple stock-for-stock trades. The Harvard Business Review points out that arbitrageurs were particularly important to the success of the cash tender offers popular in the late 1970s, where arbitrage made shares available that ordinary shareholders might not have tendered. In more complicated deals, it can be difficult for the arbitrageur to find a way to hedge against the risk that the deal will be delayed, that the deal will fail, or that the deal will be consummated at a different, far less advantageous, price. Arbitrageurs can thus be seen as profiting by assuming risks that ordinary shareholders are not willing to accept.

The ordinary shareholders reduce their risk by selling to the arbitrageur at the current price; the arbitrageur runs the risk that the deal will not close at a price above what he paid for the shares. Arbitrage is such an important element in deal-making that it is not uncommon for 40 percent of a company's stock to be held by arbitrageurs while a deal is being negotiated and approved.

### THE PONZI WAY

A challenge of successful arbitrage is financing the arbitrageur's purchases until he is able to sell at the desired price. In one early example of criminal activities related to arbitrage, the illegal activity was not the arbitrage itself but the financing used to make it possible. In 1920, Charles Ponzi concocted an arbitrage scheme to buy postal coupons in Spain and sell them to the U.S. Postal Service at a higher price. Promising his investors a 50 percent return in 90 days, he inevitably found himself paying earlier investors with capital raised from later investors, rather than from the proceeds of successful arbitrage. His Ponzi scheme defrauded 40,000 people of \$5 million.

A related challenge is finding deals in which the profit to the arbitrageur outweighs the costs of the transaction, including financing, taxes, and trading fees. Boesky optimistically suggested that a 40 percent profit on a deal is both desirable and achievable. His investment partnership did indeed, in the early 1980s, average 44 percent returns, according to a glowing 1984 profile in *Fortune*. After Boesky in-

corporated, his success rate was lower, but his business was able to offload most losses onto his investors. For his ability to know in advance what deals were happening, Boesky credited an extensive research effort. "At any one time he has six Wall Street law firms researching a particular deal," an associate told *Fortune*.

### THE CRIMINAL ELEMENT

Two years later, Boesky was arrested—and later convicted—for insider trading. His research turned out to include secret deals for confidential information from Wall Street investment bankers such as Dennis Levine of Drexel Burnham Lambert and Martin Siegel of Kidder Peabody. While Boesky's ostensible strategy had been to buy the stock of companies that looked like attractive takeover targets, hoping that a takeover would materialize, Boesky's inside information allowed him to buy stocks of companies whose takeover was a near certainty but had not yet been announced. His risks were thus minimal; in some cases, his inside information probably drove up the costs to the acquiring company.

In the wake of the arrests of Boesky, Levine, and Siegel, the primary risk of risk arbitrage seemed to be not losing money but being arrested for trading on information that the arbitrageur might or might not have realized was illegally gained. One Wall Street investment banker told *Fortune* in 1987 that, with the new paranoia, "Most arbs are not even obtaining information they are legally permitted to have." Another commented: "Have you noticed how much hugging is going on lately on Wall Street? We're checking to see if the other guy is bugged."

The practice of risk arbitrage rebounded in 1994, when GE made its bid for Kemper. However, the new arbitrageurs did not secretly buy stocks in the manner of Boesky. Instead, they worked the phones to see that the deals on which they were betting would be consummated successfully. "I make it my business to make companies behave," explained Guy Wyser-Pratt, one of the survivors of the 1980s arbitrage boom.

Corporate staff, in turn, complained that their phones were swamped with swarming arbitrageurs trying to influence the deal. However, the big insider trading rings were apparently gone; the U.S. Securities and Exchange Commission (SEC) pursued few

or no insider trading cases against arbitrageurs in the 1990s.

Although risk arbitrage has dominated headlines, it is far from the only form of arbitrage. Indeed, there is potential for arbitrage wherever there is a potential for markets to set different values for the same security or for a portion of the same security. Since arbitrage tends to push values in different markets toward convergence, arbitrage opportunities appear and vanish quickly. For instance, successful arbitrage firm Louis & Dreyfus & Cie., whose founder declared "Arbitrage is salutary hygiene," made its move in the mid-1990s to exploit price-setting confusion resulting from deregulation of the U.S. electricity market.

The government also acts to close arbitrage opportunities. For example, in 1994, the U.S. Internal Revenue Service (IRS) cracked down on municipal bond deals in which the debt is so heavily back-loaded that the funds will never be used for improvement projects, a maneuver hidden with bogus insurance so that investors can collect interest from a separate investment rather than from the results of the project. The major principal, explained a Treasury official, is that "a guarantor, bondholder, or any similar party cannot obtain the benefit from borrowing at tax-exempt rates and investing at taxable rates." In 2001, the cities of Bakersfield and Palm Springs, California, were arguing that a new IRS audit into their bonds was unfair, as the bonds had previously been declared tax-exempt and appropriately structured.

Increasingly, arbitrage opportunities involve "making companies behave," with arbitrageurs taking a more active role in corporate decision-making. For instance, fund arbitrage of the late 1990s involved targeting closed-ended funds, whose shares inherently tend to decline in value after purchase. Arbitrageurs would find a fund whose disgusted investors were willing to sell shares to them at a discount, then use the power of their large share to force the fund to become open-ended, allowing them to cash out at a profit.

Enthusiasm for manipulating company performance sometimes takes a less-than-savory turn, as arbitrageurs and other hedge-fund speculators attempt to use bad word-of-mouth to drive down stocks they've sold short. Author William Safire argues that the rise of hedge funds (private pools of investors, left relatively unregulated and often reliant on short-selling) increases market volatility,

making investing too dangerous for individuals. While classic economic theory claims that, as the time to disseminate information decreases, arbitrage opportunities should be fewer, since all markets will set values based on the same information. Thus legend has it that, in the early 1990s, a firm spent \$35 million on a supercomputer in order to gain a 2-second advantage in arbitraging stock futures (contracts to buy or sell a stock at a target price in the future) in Tokyo, Japan.

Other analysts argue that markets are inherently not capable of perfect efficiency because investors can make different, equally rational, responses to the same information. Some investors are interested in long-term gains, others in short-term gains. Markets can also price securities differently, these analysts argue, because some investors rationally, but wrongly, expect prices to rise or fall.

## MUTUAL FUNDS

For the present, time-based differences in information continue to present opportunities to profit illicitly from arbitrage. As of September 2003, New York Attorney General Eliot Spitzer was investigating several mutual funds for their policies of allowing a few select customers to trade shares at the daily closing price after the ordinary daily deadline, thus giving them the benefit of late news that would affect the fund's value the following day. This illegal arbitrage strategy was estimated by some researchers to reduce the fund's value to ordinary investors by a full percentage point. Said Spitzer after successfully prosecuting one hedge fund for \$30 million in illegal profits: "Allowing late trading is like allowing betting on a horse race after the horses have crossed the finish line."

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Boesky, Ivan; Milken, Michael; stock fraud; securities fraud; Securities and Exchange Commission.

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## Archer Daniels Midland

BY THE MID-1990s, Archer Daniels Midland (ADM) became one of the largest transnational corporate producers of food in the world, partly as the result of financial subsidies provided by the U.S. federal government. While ADM has been instrumental in the development of the technology of genetically modified food and crops, company executives were convicted corporate criminals.

In the early 1990s, ADM conspired with Asian companies to fix the prices of lysine (an amino acid), a feed additive used to increase the proportion of lean meat in farm animals, a high-fructose corn syrup (a sweetener in soft drinks), and citric acid (a common substance used to provide flavor in food) in order to improve profit.

In 1989, ADM built the world's largest lysine plant and hired Mark Whitacre to manage the production division of lysine as well as the bio-products section. Initially, ADM offered cheaper lysine than its U.S. competitors, and as a result controlled half of the market. This resulted in a large oversupply, a price war, and ADM's loss of millions of dollars monthly. ADM then brought in Terry Wilson, the president of the Corn Processing Division to assist Whitaker in his role in the company. Wilson's role was to teach Whitaker how "fix prices," a commonly condoned practice at ADM, exemplified by

former Chief Executive Officer Dwayne Andreas, who once told his son, Michael, "The competitor is our friend and the customer is our enemy."

ADM's primary competitors in the lysine business were two Japan-based transnational corporations, Kyowa Hakko (and its United States-based subsidiary Biokyowa) and Ajinomoto with U.S. subsidiary, Heartland. Hakko and Biokyowa were the first companies to produce lysine. In the 1980s, these Japanese companies were selling \$30 million a year worth of lysine to the United States, and it was cheaper than the lysine made by U.S. organic chemical companies. ADM discovered that the Asian-based companies were buying dextrose from the United States and using it to develop their cheaper version of Lysine.

While Whitaker considered not complying with this philosophy of support for price-fixing, he remained at the company to try and do things differently. By 1992, lysine prices were at the lowest point and, thus, ADM began meeting with representatives of Ajinomoto and Hakko in Tokyo to engage in a price-fixing scheme. The agreement to fix prices was initially made at a series of meetings beginning as far back as 1992 in Mexico City. At that meeting and two subsequent meetings, ADM executive Terrance Wilson told other producers of lysine that "we are not cowboys, we should be trusting and have competitive friendliness."

They discussed how the low lysine prices were only benefiting the customers, not the manufacturers. So all of the companies involved agreed to raise the price of lysine. A series of additional meetings occurred throughout the year and included Korean companies as well. They formed what they called an Amino Acid Association.

Finally, six major lysine producers established sales quotas and prices for specific regions of the world. Later, ADM executives, Michael Andreas and Whitaker began to suspect that the Japanese companies were sabotaging the Decatur, Illinois, plant and brought this to the attention of the Federal Bureau of Investigation (FBI). While no evidence of actual sabotage was found, this initial relationship with the FBI led Whitaker to become concerned about the FBI discovering the price fixing, so he informed the FBI on his own initiative, and became an undercover agent for the FBI (sometimes referred to as a whistleblower).

However, Whitaker alleged that he was forced, through threat of legal sanctions by the FBI, to con-

tinue his involvement beyond his own wishes and provided a variety of recordings of his dealings at ADM.

In 1995, a grand jury issued subpoenas for all information on price-fixing by ADM and its co-offenders. Subsequently, the FBI raided the company's headquarters and seized a variety of relevant documents. Meanwhile, Whitaker was fired for alleged embezzlement, after the company found out he was assisting the FBI. ADM sued Whitacre for \$30 million and he retaliated by accusing the company of knowingly selling contaminated cattle feed. Whitacre was later convicted of stealing millions of dollars from the company and, although he initially claimed that the money was provided by ADM as a bonus, he later confessed to taking millions of dollars from the company.

By February 1996, farmers, cattle owners, and stockholders filed 85 class-action lawsuits against ADM. Moreover, the U.S. Department of Justice also filed conspiracy-to-fix-prices charges. In 1996, ADM was charged with violations of the Sherman Antitrust Act. Finally, three Asian co-defendants in the case pled guilty and provided information about ADM to the government. These three defendants paid over \$20 million in fines for conspiring to raise the price of lysine. A month later in 1996, ADM pled guilty to two counts of collusion to set prices on citric acid and lysine and paid \$100 million in penalties, \$70 million in the lysine case, and \$30 million in other penalties. ADM also cooperated with the Justice Department with regard to prosecution of Michael Andreas and Wilson.

Subsequently, Dwayne Andreas stepped down as chief executive. Even though these were the largest fines to ever be brought against an American corporation for antitrust violations, it was still small in contrast to the profits that ADM made from the price-fixing scheme. Many of these details were publicly suppressed by the Justice Department as the result of ADM's cooperation, in addition to the fact that ADM was granted immunity on the charges of price fixing of the high-fructose corn syrup. In 1996, a federal grand jury indicted Whitacre, Michael Andreas, Wilson, and the director of Ajinomoto on charges of conspiring to fix the global prices for lysine. Whitacre was also charged with 45 counts of wire fraud, money laundering, conspiracy, obstruction of justice, filing false income tax returns, and interstate transportation of stolen property. He tried to commit suicide

as the result of his argument that the government was hurting him, when he cooperated with the FBI all along.

In March 1998, Whitacre was sentenced to nine years in prison and was ordered to repay \$11 million to ADM. In September 1998, Michael Andreas, Wilson, and Whitacre were convicted of conspiring to fix lysine prices. Although the maximum punishment for such offenses could have been three years in prison and a fine of \$350,000, Andreas and Wilson were sentenced to two years in prison and fined \$350,000. Whitacre was sentenced to another two-and-a-half years for the price-fixing.

## GENETICS

However, ADM still stacks conditions in its favor by selling nongenetically modified grains at a higher price than the genetically modified ones. It remains a leader in food sales and exports, and is one of the largest grain suppliers in the globe; ADM still has a great deal of control over whether or not the food we eat will be genetically modified. While some countries, such as Great Britain refuse to sell such food products, that does not prevent genetically modified food from appearing in our diets as over three-quarters of the world's genetically modified crops are fed to farm animals, thus genetically modified food remains present in the food chain.

In 2003, ADM was working on the production of second-generation genetically modified crops that will provide food with medicines and nutritional supplements. ADM maintains production companies in over 40 countries across four continents with subsidiaries operating under different names.

## SEE ALSO

price fixing; embezzlement; conspiracy; antitrust.

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## Argentina

A CENTURY AGO, Argentina was one of the richest countries on earth. Now, after decades of mismanagement, corruption, and repeated financial meltdowns, the over-indebted country finds itself gripped with rising levels of poverty (50 percent of Argentines lived under the poverty line in 2003), unemployment, and crime.

In the case of Argentina, one cannot talk about organized crime as a phenomenon existing on the margins of society because of the active involvement of political, law-enforcement, and military officials in criminal activities. Thus, aspects of white-collar and corporate crime and intertwined with other criminal categories. In 2001, for instance, former President Carlos Saúl Menem spent six months under house arrest for his alleged involvement in illegal arms sales to Ecuador and Croatia, which was under a United Nations arms embargo. Until the Argentine Supreme Court unexpectedly dismissed charges against Menem, his economy ministers and others, it was alleged that the president had received large payments, deposited in a Montevideo (Uruguay) bank account, for his assistance.

Menem has also been dogged by accusations that members of the security services were actively involved in the July 1994 bombing of the Jewish Community Center in Buenos Aires, which claimed the lives of 85 people. It is also alleged that the president and other high-ranking officials were handsomely paid for their complicity in the attack.

In January 1997, on the orders of Alfredo Yabrán, a politically connected underworld kingpin, prominent photo-journalist José Luis Cabezas was shot to death in Buenos Aires. The journalist had been investigating the Jewish community center bombing, and the activities of Yabrán who was found guilty of masterminding the murder in February 2000. The murder of Cabezas marked the beginning of a troubling trend in newly democratic Argentina: the attempt to muzzle or coerce investigative journalists reporting on official corruption and organized crime by using lawsuits, assassinations, attempted killings, beatings, and other forms of criminal intimidation, harassment, and blackmail.

In spite of the economic crisis, Argentina remains an important market and trans-shipment point for international, illegal-drug smugglers, but

there is as yet little drug production in the country. Since the crash of the Argentine peso and cash-crunch, individual Argentines barter their possessions (jewelry, for instance) for drugs, while the gangs exchange stolen luxury vehicles and arms for theirs.

Many have also turned to cheaper drugs such as crack and *bazuko* (poorly refined cocaine paste usually mixed with a number of chemical products and smoked with tobacco or marijuana), while dealers (mindful of shrinking profit margins) have been diluting and adulterating their products with a number of dangerous chemicals. Argentina also remains an important trans-shipment point for cocaine and heroin, produced in Bolivia, Peru, and Colombia, destined for the United States, Europe (going primarily through Spain), and Australia (often via New Zealand).

Another area of concern is the Triple Border area which has been characterized as a haven for smugglers, traffickers, scoundrels, and terrorists. Since the terrorist attacks of September 11, 2001, the area has come under increased scrutiny from Argentine and international intelligence agencies because of its links to international terrorism. The Triple Border (total population of some 600,000) is made up of three cities: Foz de Iguazú (Brazil); Puerto Iguazú (Argentina) and Ciudad del Este (Paraguay). The latter is a hub for arms, drugs, and people smuggling, as well as product piracy (cigarettes, electronics, and consumer goods), currency and document counterfeiting, stolen vehicles, and money-laundering.

Such crimes are starving Argentina's state treasury, while increasing violence and the threat of kidnapping are keeping international investors away. This is why Argentine President Néstor Kirchner took action in the early 2000s to crack down on tax evasion, money-laundering, and crime, but the lure of easy profits remains strong for most.

### SEE ALSO

money laundering; tax evasion; drug trafficking.

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## art fraud

ART FRAUD IS THE deliberately false representation of the artist, age, or origins of a work of art in order to reap financial gain. Forgery of a famous artist’s work is the best-known kind of art fraud. But fraud may also result from the knowing misattribution of the age or origin of a work of art, for example if an art dealer were to falsely assert, for the purpose of making a greater profit, that a statue was from 5th-century Greece, or that a vase was from the Chinese Ming dynasty; works from a particular region or time period may be deemed more valuable on the contemporary art market. Art fraud is motivated by the large sums of money that can be obtained for works of art by famous artists or are otherwise rare or unusual.

The copying of famous works of art dates to the origins of the history of collecting, and therefore to the beginning of the history of art. In the ancient world, replicas were made of famous works in order to satisfy demand by collectors for these works. One such statue was the 5th-century *Spear-bearer* by the Greek artist Polykleitos that had great fame for its perfect proportions and beauty, and was often copied for admiring Roman collectors in subsequent centuries. Polykleitos’ statue, made of bronze, did not survive into the modern era, but the classical Roman marble copies remain, and these copies supply our only knowledge about the original.

A copy of a famous work does not constitute art fraud; rather it is the sale of a copy under false pretenses that is fraudulent. It was in the Renaissance that intellectual property, the idea that an artist creates a work of art that belongs to her, again became a significant factor in artistic production. When the value of a work of art resides not solely in the beauty of the object itself but also in the name of the creator, there is motivation for fraudulent claims of authorship. The Renaissance artist Michelangelo (1475–1564) objected to the misattribution of his work; it was reported that when he

discovered that another artist was receiving credit for sculpting the famous *Pietà* (today in Saint Peter’s basilica in Rome), Michelangelo returned with his chisel and added his signature across the center of the sculpture, on the prominent sash across the Virgin Mary’s upper body: “Michelangelo Buonarroti, Florentine, made this” (English translation).

In the 18th and 19th centuries, the mania for classification and study of the past resulted in an upsurge in forgeries as the art market adjusted to accommodate the new interest in the artistic past. This interest in the classification of the past also led to the founding of academic disciplines such as the history of art. The study of art history and the creation of agreed-upon bodies of work for artists and eras, as well as the advances of science, have made possible in the 20th century the winnowing out of forgeries and fakes from authentic works. As art historians gain more knowledge about the past and the style, materials, and working conditions of artists and historical epochs, fraudulent works are more readily exposed.

## DETECTING FRAUD

Despite this kind of knowledge, it is still today a complex undertaking to detect art forgeries. It is especially difficult to weed out forgeries in the work of modern artists whose large numbers of works and contemporary fame make them more attractive to fraudsters. Pablo Picasso, for example, was a prolific artist, creating a huge number of works on canvas and on paper. Considering the number and the varying styles and media in which he worked, the established number of his works is difficult to pin down. His fame and the prestige associated with owning one of his works has offered strong motivation to forgers, and the difficulty of precisely attributing a Picasso, especially a drawing, makes fraudulent representations of his work hard to control.

The work of the artist Salvador Dalí (1904–89) is also vulnerable to forgers because he also created a large number of works on paper. Dalí inspired another set of complicated issues with regard to authenticity on the occasions when he signed blank pieces of paper before the print runs of his work. An assertion of illegal activity in the art market depends on tenets of intellectual property: Dalí was entitled to the proceeds of his own work and collectors who buy a work by the artist should be able to

have confidence that it is authentic. But the artist himself subverted the idea of authenticity by applying his signature to something that had not yet been created.

Certain contemporary conditions have increased the prevalence of art fraud. The popularity of art as an investment in the 1980s and 1990s propelled the art world to greater visibility and expanded the market for works of art. With more collectors and museums vying for an ever-smaller number of works by famous artists or from esteemed eras in the history of art, motivations for fraud have been exponentially increased. At the same time, modern science has made it possible to authenticate works of art to a greater degree than at any time in the past, though even these scientific tests lead at times to ambivalent results about the age and/or authenticity of a work.

Forgers may attempt to trick scientific tests by using or plausibly imitating authentic materials. A famous case is that of the forger Han van Meegeren (1889–1947), who used a paint mixture that was modern, but that sufficiently copied an older technique so that his paintings were certified, as he intended, as originals by the Dutch 17th-century master Johannes Vermeer. The masking of the age of paint materials usually can be discovered with further testing, but often museums or collectors are satisfied with initial results and the fake may pass without further testing.

Art fraud is difficult to control because the art market is enormous, unwieldy, and greatly varied, stretching from Victorian buttons to Greek 6th-century vases, from medieval pilgrims' badges to contemporary photographs. Business is often conducted under the veil of secrecy, with buyers wishing to remain anonymous to avoid the attention of burglars and other opportunists. It would be logistically impossible to monitor all of the transactions between dealers, private collectors, and museums that are in the business of acquiring art.

Suspected art forgeries can generally only be considered on a case-by-case basis, because they can usually be identified only by an expert in the field. But experts themselves may be biased to find particular characteristics in an "authentic" work, and it is not unusual for two experts to have wildly different opinions of the authenticity of the same object, based in each case on reputable evidence. Forgers also have strategies to avoid detection, such as van Meegeren's paint materials, that were appropriate to

the era and artist. The identification of fraud is also complicated by the emotions involved with collecting. Collectors may be taken in by forgeries simply because they desire to own the work of art so greatly that their reason is clouded by emotional attachment; they may simply wish to believe that it is authentic.

The difficulties of authenticating works of art are also complicated by collecting areas such as Australian aboriginal art, where the Western standard for production, in which one artist creates a work that is then sold on the market with that artist's name, is not necessarily a part of the indigenous artistic tradition. The production of Aboriginal art itself has been affected by art fraud, as Aboriginal artists alter their methods of production in order to satisfy demands by the art market for "authenticity."

Art fraud is directed by the way in which value is assigned to works of art in the market. Generally, the most valuable works are those that are most rare, such as Old Master paintings, those that are most desired at a particular moment (by a new artist who witnesses a rush on her works, for example), or from a particularly esteemed period, such as American Abstract Expressionism. These values can fluctuate based on the larger economy, or on particular biases (contemporary artists are particularly vulnerable, for example, to the vagaries of fashion), or on publicity. For example, an exhibition on Paul Cezanne landscapes might inspire a jolt upward in values of these works, or a movie on Jackson Pollock that broadens the visibility of his work might increase demand. Art fraudsters then illegally meet the demands of the art market by supplying these highly desired works of art under false pretenses. There is a focus in the media on art fraud involving paintings and sculpture, but counterfeiting of jewelry and other minor arts may indeed be more common. These small works are more easily disguised since the authentic works are less well-known.

## SMUGGLING AND PROVENANCE

Another area of art fraud motivated by the demands of the art market involves the smuggling of works of art out of countries, especially in the third world, where the value of the work may be poorly understood. Though smuggling is in itself a crime, art fraud may also occur when the smugglers make it seem to guardians of cultural patrimony or cus-



toms officials that the works are not at all valuable. They then appear on the market in wealthier countries for sale for large sums. There are sanctions against museums that buy these works, but governments of these countries have little recourse when the objects disappear into private collections.

An important strategy for combating art fraud is research into the history of ownership of the work (called provenance) and the mention of the work in archival records. Genuine works of art appear in historical records and are owned by individuals, and one way to determine the authenticity of a work is to establish this kind of history. Marks of ownership may be found on the object itself, such as owner's stamps, or dates signifying change in ownership may be written on the object. Needless to say, it is also possible to forge historical marks on a work, so it is not possible to say definitively with only provenance research that a work is genuine.

Fraud may also result from a falsified provenance. Provenance is crucial to a work's market value, because art museums generally avoid purchasing works of art that do not have a provenance (for fear that they may have been stolen, and that the wronged owner may surface and claim the work). It is also bad publicity for a museum, especially a public museum, to be associated with any fraudulent activity in the art world.

## EMBARRASSMENT

Finally, art fraud is difficult to prosecute because it may require an embarrassing admission on the part of the collector or the museum curator that he has been duped. This lack of willingness from those who were conned inhibits the exposure and investigation of fraud. Museums, for example, only very rarely acknowledge that works of art in their collection are perhaps not authentic. The Museum Boymans-van Beuningen in Rotterdam, Holland, was forced to acknowledge that the *Supper at Emmaus* in their collection, supposedly by Johannes Vermeer, was actually painted in the 1930s by van Meegeren, but only after the forger himself admitted it, in the context of another investigation. The original collector, D.G. van Beuningen, continued to refuse to believe, despite this admission, that the work was not by Vermeer.

In addition, museums are loathe to announce that a work of art may be fake, only to later perhaps discover that it is authentic. Such a complicated

case is that of the Getty *Kouros*, an allegedly 6th century B.C.E. male sculpted figure owned by the J. Paul Getty Museum in Los Angeles, California, that has been under constant suspicion that it is a modern forgery. The Getty paid a very high price for what it believed was one of the only remaining 6th century *Kouros* figures on the art market, only to discover that it had stylistic irregularities that suggest it cannot be authentic. At the same time, scientific tests have not shown it to be a modern forgery, and some scholars argue that the stylistic anomalies are not necessarily evidence that it is a fake. The Getty exhibits the works in its galleries with a label that reads: "circa 530 B.C.E. or modern forgery."

## VICTIMS

The victims of art fraud are the artists and museums who own the works, collectors who are defrauded through purchase of forged works, and museums who may use public or donated money to buy fraudulent works of art. Countries that lose valuable works of art to the international art market under false pretenses are also subject to art fraud. It is these owners and collectors of works of art that have the greatest interest in eradicating art fraud.

The Art Loss Registry is one large organization that maintains a database of stolen works of art and works to ensure and maintain the integrity of the art market. Interpol also tracks art smuggling. City police forces may also have "art fraud squads" such as that in the New York City Police department that investigate cases of art fraud on the local level. But the first, and in many cases only, line of defense against art fraud are the dealers who offer the works for sale and the museums and collectors who must make every effort determine the authenticity and legality of the works at the moment of sale.

## SEE ALSO

forgery; counterfeiting.

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## Arthur Andersen

ON JUNE 16, 2002, the accounting firm of Arthur Andersen was found guilty of a felony charge of obstructing justice in the Securities and Exchange Commission (SEC) investigation of the collapse of the Enron Corporation. At the time of the conviction, Andersen was one of the five largest accounting firms in the world with approximately 85,000 employees across the globe. Within a year of the conviction, employees of Andersen numbered less than 300.

At the order of David Duncan, lead auditor for the Enron account at the firm's Houston, Texas, office, Andersen partners and staff destroyed more than a ton of Enron documents and deleted over 30,000 e-mails and computer files that were allegedly confidential to the account. The 17-day purge ended on November 9, 2001, when the SEC issued a subpoena for Andersen to cooperate in the investigation.

Once a leader in the accounting profession, both in bringing greater accountability to publicly traded corporations and in raising the level of professionalism for accountants, Arthur Andersen & Co. had earned a reputation over its 89-year tenure for responsible auditing and public stewardship. Arthur Andersen, a professor at Northwestern University, guided the Chicago-based partnership through the Great Depression and two world wars. But as the firm sought to maintain profitability through the 1950s and beyond, a gradual shift of focus from public accountability to client satisfaction brought about a series of subtle changes that would lead to scandal by the late 1990s.

The primary factor in the accounting firm's changing culture was the development of consulting services. First implemented in 1952, consulting teams offered services that met needs in the changing marketplace, particularly in the area of computer technology. Despite criticisms that consulting posed possible conflicts of interest, consulting rev-

enues stabilized accounting firms such as Andersen in a corporate climate where auditing brought in decreased revenues at greater risk of litigation. In 1988, Andersen's consulting services became a separate business unit by the name of Andersen Consulting. During the 1990s, consulting revenues outpaced auditing, and in August 2000, Andersen Consulting separated entirely from Arthur Andersen and became known as Accenture.

Another factor in Andersen's increasingly client-focused culture was a 1992 shift in the firm's leadership that replaced older, more conservative partners with younger individuals who supported a new stress on sales and closer relationships with auditing clients. Andersen employees were encouraged to take "out placement" jobs with client firms and client satisfaction became the firm's focus rather than the traditional public stewardship goal of previous decades.

After this leadership shift, Andersen became embroiled in a number of litigations, including the Baptist Foundation of Arizona (BFA), Sunbeam Corporation, Boston Market Trustee Corp., Department 66, and Colonial Realty, most of which were settled with little media attention. In the case of Waste Management, Inc., the SEC charged that Andersen had issued five years' worth of misleading audit reports and levied a fine of \$7 million to settle the case out of court, then the largest fine ever levied against an accounting firm, and Andersen paid \$75 million to settle civil lawsuits.

SEC Chair Laura Unger cited the case as proof of why consulting services posed a clear conflict of interest: Andersen Consulting had collected a total of \$11.8 million from Waste Management; Arthur Andersen had collected \$7.5 million for auditing fees.

In the case of the Enron Corporation, Andersen had engaged in questionable auditing practices that included both external and internal auditing, as well as auditing Enron's internal control system. The Enron account's lead auditor, Duncan, overrode warnings from Andersen's internal regulators and persisted in a close relationship with the corporation that centered on customer satisfaction. Andersen's auditing practices, however, were never formally indicted.

SEE ALSO  
accounting fraud; Enron Corporation; Securities and Exchange Commission.

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## asbestos

THE VERY term *asbestos* conjures up an image of greedy manufacturers so involved with profits that they ignored the safety of their employees for decades, possibly for centuries. Even when it became public knowledge that there was a direct link between exposure to asbestos and a number of diseases and deaths, those same manufacturers attempted to sidestep their responsibilities.

By definition, asbestos is a strong and flexible fibrous material that is resistant to fire, heat, and corrosion. The fact that asbestos has an infinite half-life has made it even more desirable. The properties of asbestos have made it ideal for a wide range of products that include: insulation, brake-lining, clutch facings, roofing, flooring, pipes, packing, gaskets, protective clothing, gas masks, grinding wheels, fire retardants, drywall patching compounds, dish towels, and fire-proof toilets.

Medically, the issue of asbestos has been concerned with treating the effects of exposure on the lives and the health of those who have been in contact with the material in some way. Legally, the issue of asbestos has been involved with handling the claims of litigants in courtrooms around the country. Politically, the issue of asbestos has been concentrated on ensuring accountability for those at fault, justice for those who have suffered, and prevention of asbestos-related problems for present and future generations.

Physicians and medical researchers have shown that when individuals inhale asbestos fibers, they are likely to contract asbestosis, a clogging and scarring of the lungs that may lead to reduced breathing capacity. Lung cancer has been documented as the

second most prevalent disease among those who have been exposed to asbestos. The occurrence of mesothelioma, which is a cancer of the lining of the chest and abdomen, has also been documented.

This latter form of cancer progresses rapidly, is always fatal, and has been identified only in patients who have been exposed to asbestos. Workers exposed to asbestos are most likely to be males who worked in shipyards or in factories that produced insulation or other asbestos products. Even after the use of asbestos was prohibited in the late 1970s, maintenance workers by the thousands were exposed during asbestos-removal projects because they neglected to use respirators, and through improper handling of discarded asbestos material. It has been estimated that by 2013, between 74,000 and 265,000 asbestos-related deaths will have occurred. Government estimates place the number of workers exposed to asbestos at 11.5 million. In that same period, it is expected that compensation from asbestos-related claims will have cost Americans between \$4 billion and \$38 billion.

## ASBESTOS IN HISTORY

Some researchers have documented the use of asbestos as far back as the time of Jesus Christ when historian Pliny referred to using the transparent bladder skin of animals as inhalers to protect slaves from inhaling disease-causing construction material. By the 1930s, scientists in the United States, Great Britain, and Germany had documented the connection between exposure to asbestos and cancer. Researchers noted that while even slight exposure to asbestos could cause cancer; the risk was highest for those who were exposed to large amounts of asbestos over a long period.

As early as 1943, records show that the asbestos industry in the United States was aware of medical reports on asbestos as a carcinogenic. Despite knowledge of the dangers of asbestos, until the 1970s employers continued to use asbestos products and failed to provide employees with warnings about the dangers. Use peaked in 1973 when 795,000 metric tons were used. By 1979, that number had dropped to 560,000 metric tons.

From the beginning, a number of significant factors came into play with the asbestos issue. First, asbestos products have been widely used in a number of American homes, buildings, and automobiles over a lengthy period of time, exposing

millions of people to the effects of asbestos. Second, the lengthy period between the time of exposure to asbestos and the onset of asbestos-related diseases has raised questions about the legitimacy of the initial claims. From 15 to 40 years may elapse between exposure to asbestos and the appearance of asbestos-related diseases. For example, individuals who were exposed to asbestos in shipyards during World War II became ill and filed lawsuits in the 1980s.

Third, the stakes involved in asbestos cases have been enormous. Workers' compensation policies have generally prevented workers from filing claims against their employers, so litigants have sued asbestos manufacturers, suppliers, and processors who declare bankruptcy to prevent their companies from going under. Over 50 percent of asbestos-related cases have been dealt with by federal courts. By 1983, lawsuits had been filed in 48 states. Almost 70 percent of the cases filed in state courts involved California, Massachusetts, New Jersey, Pennsylvania, and Texas.

Asbestos suits were most likely to name the Manville Corporation, which was the largest asbestos manufacturer in the world, employing 25,000 workers in more than 50 factories and mines in the United States and Canada. Other defendants in asbestos litigation included: Fibreboard Paper Products, Pittsburgh Corning, Owens-Corning, Union Asbestos and Rubber Company, Combustion Engineering, Eagle-Picher, Philip Carey Corporation, Armstrong Convecting and Supply Corporation, Rubberoid Corporation, and Standard Asbestos Manufacturing and Insulating Company. Finally, the outcome of the asbestos cases had an enormous impact on other litigation that had arisen from other toxic torts.

The first asbestos lawsuit was filed in August 1961 by Claude J. Toplait, a 20-year veteran of the asbestos industry. Toplait had been diagnosed with severe shortness of breath as a result of extensive lung damage and "finger chubbing," a thickening of the fingertip tissue. He had also been tentatively diagnosed with pulmonary dust disease. All three conditions were caused by exposure to asbestos. Toplait received a \$75,000 settlement. Over the next three and one-half years, new medical information on asbestos-related diseases surfaced, firmly documenting the link between asbestos exposure and an increasing number of deaths and diseases around the country. The research of Dr. Irving J. Selikoff of

Mount Sinai School of Medicine was particularly significant: he believed that there had been between 8,000 and 10,000 thousand deaths in the United States between 1940 and 1980 due to exposure to asbestos.

In mid-1965, the American Law Institution published a new definition of tort law that called for strict liability on the part of manufacturers and sellers of harmful products. The reform made it easier to bring lawsuits, and an influx of asbestos-related cases were filed. The decision was made to certify asbestos claims as class action lawsuits because individual lawsuits were resulting in vastly disparate judgments varying from a few thousand to several million, and these cases were clogging court calendars throughout the United States judicial system.

Participants in class action lawsuits also had the advantage of teams of lawyers, researchers, and expert witnesses that gather and present evidence to support their claims. It became evident early in the investigation into asbestos claims that manufacturers had willfully covered up the health dangers related to asbestos exposure. The Asbestos Claim Facility (ACF) was created to oversee disbursement of the millions of dollars in asbestos payments awarded to claimants.

#### SEE ALSO

Johns-Manville; employee safety.

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## Asia

ASIA IS A VAST continent, home to around one half of the world's population. It encompasses the deserts of Arabia to the west, the frozen wastes of

Siberia to the north and the heavily populated cities of India and China to the south and east. Each part of the continent has been home to a variety of ethnic groups, cultures, and religions. As these have met and interacted, it is no surprise that a great number of attitudes and approaches to business have developed over the years.

As a result, the relationships between business organizations, government and society are significantly different across the continent. Although there has been a degree of homogenization of systems as a result of the emergent dominance of Western style capitalism and globalization, significant differences still remain.

When members of different systems came into contact with each other, there can be an appearance of abuse as well as its substance. For example, in many parts of mainland Southeast Asia there is a legacy of voluntary bondage as security for loans or to meet debit payments, that has become aligned with some forms of industrial working conditions considered unacceptable by most of the Western world. Similarly, the need perceived by successive administrations of South Korea to create a strong industrial base to mitigate against the possibility of invasion by North Korea has led to systemic attacks

on workers' ability to organize themselves into labor unions. Throughout the continent, the spectre of communism has been used to justify strong government-business links which have given rise to some large-scale conflicts of interest as well as abuse of the working classes. Conflicts of interest have often focused on the ownership of natural resources and the right to profit from their exploitation, often linked with environmental degradation, the maintenance of secrecy regarding business agreements when security interests are cited, and the practice of business people buying undue influence with government officials and agencies.

### ASIAN APPROACHES

Much of western and southern Asia is dominated by Islam and, as the Islamic world has moved closer to or further from fundamentalism, distinctively Islamic attitudes toward business have emerged or retreated. As the prophet Muhammad himself was a merchant, Islamic belief has generally embraced commerce as an appropriate and moral activity. Other Asian thought systems have more problematic approaches to trade. Confucianism, for example, attaches great importance to the perfection of



*Tokyo, Japan, has its own variety of business and corporate crime.*



*Hong Kong, China, has remnants of British colonial corruption.*



*Shanghai, China, mixes capitalism crimes with communist politics.*

the individual in this world and the importance of harmony and order in relationships at all levels.

Buddhism, too, is concerned with the avoidance of bad or immoral deeds which will come to punish the individual in this life or in a future incarnation. Both of these thought systems are amenable to regulation by states to require business people to submit to the will of the state, and to avoid the search for profits above all else. Chinese, Korean, and to a lesser extent Japanese state beliefs required individuals to remain active only within their own regional networks and, hence, make it very difficult to establish long-range trading networks without sacrificing social standing. In these cases, along with the caste society of India, separate classes of people either specialized in, or were required to undertake commercial issues, and it was considered perfectly acceptable for the state to tax them at whatever rate might be desired.

As a general rule throughout the continent, business is conducted on the basis of trust and relationships rather than of written, contractual agreements which are more common in the Western world. This means that the Asian business person will be as interested in the background, family, and network connections (university, hometown, or other affiliation) rather than specific products or services being marketed. It is as a result of these kinds of relationships that cross-border trading networks have been established to assist the growth to prominence of Chinese migrants throughout East Asia, and further afield, also Indian migrants overseas.

#### EAST ASIAN WHITE-COLLAR CRIME

The rapid economic development of the Asian "Tigers" or newly industrializing countries of east Asia, especially the Republic of Korea and Taiwan, provided examples of heavy protectionism, export promotion and the extensive use of government-linked corporations. The attempt to secure rapid industrialization and economic development was rendered more urgent by security considerations, since both felt the threat of more powerful militaristic neighbors with strong motives to overrun them. The business environment created in these cases (and in the strict societal and business control also enforced in Singapore, another of the Tigers) has stimulated a number of ethical concerns which hinge upon the tension between personal liberties

and the national interest. Western companies doing business with these states must consider whether it is consistent with such ethical positions as they may have professed to collude in the suppression of labor rights, among other issues.

#### COMMUNIST CAPITALISM

The collapse of the Soviet system has released a number of states in central Asia from command economies and strongly controlled political regimes. The regimes that have replaced those enforced by the Soviet system have proved themselves to be of varied utility to their people, many of whom have become alienated from the state which is viewed as predatory to their interests. As a result, corruption and fraud have grown to significant levels as individuals have no reason to believe that the state will concern itself with their interests.

This, combined with weak cross-border controls, the presence of large amounts of illegal narcotics from Afghanistan and neighboring countries, numerous refugees and weapons from the many wars in the region have greatly stimulated illegal industries in prostitution, smuggling, money-laundering and human trafficking. Similar stimuli are also present in China and Vietnam, states which retain an overt communist state ideology, but which have economies moving through transition toward market-based systems; this has produced high levels of white-collar crime.

#### FINANCIAL CRISIS OF 1997

In 1997, the onset of an Asian financial crisis was signaled by attacks on the baht, the currency of Thailand. As a result of some weaknesses in banking systems, the irrationality of international investors and unevenness in the economic development of various East Asian states, a form of financial contagion then passed through the Philippines, Indonesia, Malaysia, Korea and other states, affecting each to a greater or lesser extent. Those affected most severely were obliged to accept both emergency assistance from the International Monetary Fund (IMF), and the conditionality attached to the loans.

The impact of the financial crisis, which was worsened by IMF conditionality, caused large numbers of bankruptcies and cut redundancies. Many of those who lost their jobs were able to return to

provincial homes and pick up agricultural activities. However, for those for whom this was not possible, alternatives included prostitution or becoming involved in crime. Inevitably, job losses took their toll on the most vulnerable and those least able to protect themselves, and these people also became prey to human traffickers and to unscrupulous overseas labor agents.

#### SEE ALSO

Japan; China; Thailand; Africa; South America; organized crime; human trafficking; drug trafficking; money laundering.

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## AT&T

AMERICAN Telephone and Telegraph (AT&T) traces its roots back to founder Alexander Graham Bell's invention of the telephone in 1875. As a subsidiary of American Bell, AT&T began to manage long-distance services in 1884. Within four years, AT&T had become the parent company in a two-for-one swap.

Financial wizard J. P. Morgan took over the company in 1907. Morgan decided that AT&T would grow through acquisition, and AT&T developed a reputation as a "ruthless, grinding, oppressive monopoly." AT&T resisted efforts to curtail its progress for the next 70 years.

By 1888, both the Democratic and Republican party platforms called for antitrust legislation, and the U.S. Congress complied with the Sherman Antitrust Act in 1890. Beginning with the presidency of Theodore Roosevelt, the U.S. government was determined to bring an end to the anticompetitive actions of large trusts. The federal government began to keep a watchful eye on AT&T after a 1909 merger with Western Union. The following year, the Interstate Commerce Commission (ICC) was given regulatory responsibility for telephone serv-

ices. In 1911, Standard Oil and the American Tobacco Company were broken into smaller divisions. Even though AT&T had given up its controlling interest in Western Union, in 1913 the government filed an antitrust suit against AT&T.

The conclusion of the investigation was that AT&T was a "natural monopoly" that had formed in response to increased demands for communication services, and to the lack of competing companies that could meet those demands as efficiently as AT&T. As a "natural monopoly," AT&T ruled the communications market for decades. However, as new technologies were developed, rivals appeared on the scene and began to challenge AT&T.

In 1934, as part of Franklin D. Roosevelt's New Deal, the Federal Communications Commission (FCC) was created and assumed regulatory responsibility for the communications industry, and AT&T became the target of its first investigation. In 1949, the government again sued AT&T for antitrust violations with the intention of forcing Western Electric and Bell Laboratories to break away from the rest of the system. The suit dragged on until 1956 when AT&T agreed to a consent decree that allowed the company to retain control of Western Electric and Bell Laboratories and promised to stop expanding into other fields of communication. However, AT&T argued that the government's actions were unfair because AT&T was prevented from expanding its services while rivals continued to make significant advances.

The federal government continued its interest into AT&T activities; in 1976, the FCC handed down what became known as Computer Inquiry II, officially ending AT&T's designation as a "natural monopoly" and nullifying the 1956 consent decree. The final element of Computer Inquiry II was handed down in 1980, making a distinction between "basic services," which were subject to federal regulation under the Communications Act of 1934, and "enhanced services," which were open to all competitors. Enhanced services included videotext, protocol conversion, information storage, packet switching, and data transmission.

While preventing AT&T from expanding into other fields, the FCC supported the expansion efforts of other companies, even when it meant using AT&T's technology and equipment. For example, in 1968, the FCC forced AT&T to allow Carter Electronics Corporation of Texas to plug the Carterfone into the AT&T telephone system. The

following year, Microwave Communications, Inc. (MCI) was allowed to develop its point-to-point microwave line and to sell private-line services to both individuals and businesses, and the government required local companies to provide links for MCI's long-distance service. MCI then began to lobby the federal government to end AT&T's monopoly. In 1974, as AT&T was attempting to comply with Computer Inquiry II, the Department of Justice filed a new antitrust suit, charging the company with monopoly and conspiracy to monopolize telecommunication services and products.

The suit reached the trial stage in 1981 despite two separate attempts by AT&T to settle out of court. Also in 1981, a federal court awarded triple damages to MCI that totaled \$1.8 billion, charging AT&T with engaging in anticompetitive practices. Not satisfied, MCI announced that it was suing AT&T for an additional \$3 billion. Two decades later, along with other long-distance carriers, AT&T sued MCI, which was in the midst of bankruptcy proceedings, claiming that MCI had routed long-distance calls through Canada, forcing AT&T to pay local phone companies for the costs of transmitting calls.

Deregulation was the order of the day in the 1980s, and the United States government finally succeeded in doing what it had begun decades before. At noon on January 8, 1982, William Baxter, the assistant attorney general for antitrust, and Charles L. Brown, chairman of the board of AT&T, announced a new consent decree that broke AT&T up into smaller companies. By 1984, the division was complete. AT&T was divided into AT&T Communications and AT&T Technologies. Long-distance services were dealt with by AT&T Communications. AT&T Technologies encompassed Bell Laboratories, network systems, technology systems, international services, consumer products, and information systems. Local rates became the province of the 22 "Baby Bells" created around the country, encompassing seven geographic regions. The "Baby Bells" were prohibited from providing information services and manufacturing equipment and were required to provide equal access to phone lines to all long-distance carriers.

Senator Barry Goldwater (R-AZ) epitomized the reactions of a number of people around the country: "I fear that the breakup of AT&T is potentially the worst thing to happen to our national interest in telecommunications that will ever occur." The im-

mediate result was general customer dissatisfaction with having to choose a separate long-distance carrier and with lengthy waits for repairs. Rates for telephone services began a steady rise of around \$200 per year. Critics of the government's actions argued that the breakup of AT&T led to everything from blocked technical services to a threat to national security.

AT&T became the number one long-distance service provider in the United States and continued to expand its service. In July 2000, the Federal Trade Commission (FTC) opened an investigation into AT&T's relationship with Time Warner in which AT&T holds a 9 percent interest. The powerhouse merger of Time Warner and America Online (AOL), approved by the FTC on December 14, 2000, caused concern among AT&T's rivals which were afraid that the AT&T relationship with AOL Time Warner would set the stage for exclusive access to communications services.

In October 2003, it was reported that AT&T and Bell South (one of the Baby Bells) had resumed merger talks that had stalled two months before. If successful, Bell South would have bought AT&T, and the merged company would become known as AT&T.

#### SEE ALSO

antitrust; Sherman Antitrust Act; ITT; Federal Trade Commission.

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## Australia

BEGUN AS a British penal colony, Australia is now one of the most law-abiding nations on earth. Nev-



ertheless, as is the case in many modern societies, the phenomena of corporate, organized, and white-collar crime have blossomed in recent years, thanks largely to ever-increasing profits. Australia holds an important position in the study of white-collar crime, namely through the work of three Australian scholars: John Braithwaite, Brent Fisse, and Duncan Chappell.

Braithwaite, a professor at Australian National University, pioneered new research and theories in white-collar crime. In his book, *Corporate Crime in the Pharmaceutical Industry* (1984), Braithwaite reports: "Pharmaceutical companies face great temptations to mislead health authorities about the safety of their products. It is a make-or-break industry. Many companies get virtually all their profits from just two or three therapeutic winners. Most of the data that the Australian Drug Evaluation Committee relies upon in deciding questions of safety and efficacy is data from other countries, particularly the United States. Inquiries into scientific fraud in the United States have shown there is a substantial problem of fraud in safety testing of drugs in America, just as has been documented in Japan."

Braithwaite's other books and work focus on corporate crime and accountability, and more recently, restorative justice and responsive regulation (examinations of retribution versus restoration in corporate criminal punishment).

Australian attorney and author Fisse is a specialist in trade practices law, intellectual property, e-commerce, and on-line services and liability control systems for corporations. He developed the theory of "organizational blameworthiness" for corporate crime and has argued that the common practice of imposing monetary penalties as sanctions against corporations does little to deter future bad behavior.

Lawyer and criminologist Chappell studies the rise of workplace violence, explaining in one paper, "Workplace violence is not merely an episodic problem created by deranged persons, but is a highly complex issue rooted in wider social, economic, organizational, and cultural factors."

Chappell's research recommends specific solutions to workplace violence, including adopting criminal and civil law remedies for not only workplace deaths, but the other end of the spectrum as well: psychological violence, whether sexual or bullying harassment.

Having made inroads in the study of white-collar crime through the work of Braithwaite, Fisse, and Chappell, Australia nevertheless has a large presence of cross-fertilized corporate and organized crime. Currently, all of Australia's major cities, and some of its smaller towns, host both Anglo-Australian and international gangs and criminal networks involved in bribery, corruption, and violent crime. Interestingly, the only groups visibly absent from the Australian underworld are the Nigerians and the Mexicans. It seems that North Koreans are getting involved in smuggling heroin into Australia, according to the federal police.

Another important concern for the authorities is illegal immigration, primarily from the Middle East and southeast Asia. Recent Australian administrations have taken a hard line toward those it considers to be queue-jumping. As a result, the federal government instituted its Pacific Solution (September 2001), whereby aliens are to be housed in camps on neighboring islands (Nauru and Papua New Guinea) where their claims will be assessed. Most of the illegal attempts to enter Australia by boat come from Indonesia, where local gangs and corrupt authorities have colluded with international smugglers. And, the Australian Immigration Department recently established a task force in order to crack down on its own corrupt agents who have sold visas (refugee and immigration) to the smugglers. Also, there is evidence that agents have colluded with international prostitution rings that have brought women from Asia and eastern Europe into Australia. Organized crime is also attracted to Australia because of its extensive financial services and gaming (primarily) industries which facilitate money-laundering.

Moreover, the country offers a safe environment (despite terrorism alerts) in which to invest in businesses, real estate, and the tourism industry. In the early 2000s, Australia decided to more actively intervene (militarily and diplomatically) in the south Pacific region in order to halt the disintegration of states which benefit from and attract international crime and terrorist networks. Australia must also contend with piracy (Indonesia and South China Sea) and states that sell their sovereignty to money-launderers (Nauru).

#### SEE ALSO

Braithwaite, John; Fisse, Brent; drug trafficking; money laundering; Indonesia.

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## automobile

SOME HISTORIANS argue that the impact of the automobile on the modern industrial age is as deep and broad as the French and Russian Revolutions or that the automobile has more profoundly influenced 20th-century American historical development than presidents or Progressives. Without a doubt, the automobile has radically changed the technological and social development of American and world history.

Henry Ford's mass production of cars marked the beginning of the motor age when the car changed from the toy of the rich to the essential transportation for the ordinary man. Trolley cars were displaced to make room for more cars. Brick streets were covered with asphalt to provide a smoother automobile ride. As more Americans owned cars, urbanization patterns changed and suburbs flourished. The U.S. government created a national highway system, and Americans became mobile, jumping into the car and going anywhere anytime.

The automobile changed social patterns as well. Young people enjoyed the freedom of the automobile and their parents feared that the automobile freed moral standards to an unacceptable level. After a century of using the automobile, the world is still experiencing and assessing the effects of internal combustion transportation. Nearly every aspect of modern life has developed around this technology. Americans are debating its impact on

their physical, political, and moral environments. With the count at 500 million cars and steadily increasing worldwide, and over 150 million cars in the United States, not counting heavy vehicles such as trucks, buses, cranes and other commercial vehicles, people have forged a lasting alliance with the automobile.

Automobile safety versus the corporate bottom line is the most pressing problem that the automobile industry faces as the 21st century progresses. Factors like increasingly high speed limits, more highways and more cars clogging them, and human error and mechanical failures have kept these issues consistently newsworthy, although not necessarily new. The February 21, 1931, issue of *Science News* pointed out that according to a survey by statisticians of the Travelers Insurance Company, more Americans had been killed by automobile accidents than in World War I. During the 18 months that the American Expeditionary Forces had fought in World War I, about 50,510 soldiers had been killed in action or died of wounds. During the equivalent amount of time in 1930–31, 50,900 persons were killed in automobile accidents in the United States. The National Vital Statistics report for the year 2000 stated that 43,354 Americans were killed in motor vehicle crashes that year.

Automobile accidents began as soon as the first cars appeared on America's rutted, dirt roads that had been hewn for horses and foot traffic. A broken arm, acquired when cranking the engine to get it started, was one of the most common Model A and Model T injuries in the 1920s and 1930s. As the automobile industry grew with the decades, so did the technology and the concern for the corporate bottom line, which made the temptation to short-change the automobile consumer irresistible for most automakers. The shift to holding automobile manufacturers accountable for the safety of their vehicles began in the 1960s when lawyer Ralph Nader challenged General Motors in his book *Unsafe at Any Speed*. Although he was young and inexperienced, Nader permanently changed the course of the automobile industry by proving that General Motors automobiles were not as safe as they could be, and revealing that although company executives were aware that consumers were at risk from their unsafe automobiles, they were more concerned with profits than probity. Nader charged that the Chevrolet Corvair exemplified the General Motor's disregard for safety. Small, state-of-the-art, light-

weight, and featuring an independent rear suspension, the Corvair proved to be popular and consumers rushed to buy the 1960 model. When data published by Nader revealed that the design of the Corvair made it unsafe and that hundreds of drivers had been injured in accidents, sales dipped correspondingly and General Motors attempted to discredit Nader. In response, he sued them, and won a \$424,000 settlement, which he used to form a consumer group to monitor General Motors. Besides paying Nader a cash settlement, General Motors admitted its guilt, creating a front-page story for newspapers across the country.

The Chevrolet Corvair was not the only unsafe automobile that companies manufactured and sold to an unwary and inadequately consumer-educated public. Under the chairmanship of Lee Iacocca, the Ford Motor Company rushed the Ford Pinto into the 1971 subcompact market without sufficient testing and safety trials. Iacocca insisted that car production was more important than safety and the 1971 model was designed and built accordingly. Because of design defects, low-speed crashes ruptured the Pinto's fuel system and caused the car to burst into flames. Using death and injury reports of Pinto accidents as a documentary basis, in April 1974, the Center for Auto Safety petitioned the National Highway Traffic Safety Administration (NHTSA) to recall Ford Pintos. The petition floated in limbo in NHTSA offices until rediscovered by 1977 events. In 1977, Mark Dowie of *Mother Jones* magazine, used these documents and Ford Motor Company memos to write an article about the Pinto which proved that Ford had known about the fuel system problem all along, but had concluded that it would be more cost effective to pay death and injury liability claims than to modify the design. As a result of this publicity, in June 1978, Ford recalled 1.5 million Ford Pintos and 30,000 Mercury Bobcat sedan and hatchback models.

In the next three decades, the road to recall continued to be a reluctant, but well-traveled one for the automobile companies. American Motors introduced the Jeep CJ line in the early 1980s and by the time it discontinued the line in January 1986, had accumulated over 570 lawsuits totaling at least \$1 billion dollars. Although General Motors halted production, Jeeps were never recalled and consumer advocate groups charged that, in 1989 alone, more than 200 people had died in Jeep accidents. A National Highway Transportation Safety Board

(NHTSB) study removed the responsibility from the manufacturer to the consumer when it stated that Jeeps were safe if they were driven properly. In 1987, American Motors Company and its Jeep division became subsidiaries of Chrysler, now DaimlerChrysler. The company continued to sell vehicles under the Jeep name, including the Wrangler and Grand Cherokee, a popular sports utility vehicle; both still posed rollover risks. Another Jeep model, the Wagoneer, which the company stopped producing in the 1980s, is still involved in lawsuits filed by families of people killed in Wagoneer accidents years into the 21st century.

## FIRESTONE AND FORD

Public Citizen, a national public interest association founded by Nader in 1971, was a prime mover in the Firestone tire defect and Ford Explorer rollover recall cases of the early 2000s. The combination of the Ford Explorer and Bridgestone and Firestone tires with their tendency to separate and cause accidents, turned out to be a lethal for hundreds of people. Internal Ford documents revealed that the Ford Explorer, first offered for sale in March 1990, had a design defect that made it prone to rollovers.

Company engineers recommended changes in the vehicle design, but Ford, which originates the tire specifications for its vehicles, instead merely removed air from the tires and lowered the recommended pressure standards. After about 100 fatalities, Firestone recalled more than 6.5 million tires in 2000. The consequences of the recall continue to reverberate as the first decade of the 21st century progresses. Previously, Firestone and Ford had attempted a cover up in the 1972 recall of the Firestone 500. When the cover up was discovered, Firestone replaced its top management but its reputation and economic status was severely damaged. In the 2000 recall, when confronted with accusations about the performance of its tire Firestone claimed owner abuse: under-inflation, rough usage or improper repair. The Firestone recall is far from over and consumer advocate groups are pushing for increased authority for the NHTSA to monitor automobile manufacturers and enough punitive powers to increase penalties and civil consequences.

People as diverse as Henry Ford and Nader have decisively steered the course of the automobile in society, and its impact on American life and the American consumer. The first decades of the 21st

century will reveal whether or not the automobile consumer will develop an equivalent social and political power.

SEE ALSO

General Motors; American Motors; Corvair; Nader, Ralph; *Unsafe at Any Speed*; Firestone.

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# B

## **bad checks**

BAD CHECKS REFER TO banking instruments (checks) that are not suitable for payment at the time they are presented to the issuer's bank. There is a presumption by the acceptors of checks that there are sufficient funds available to cover the checks. When the funds are not available to cover the check, the check "bounces." It is declined for payment as the account has insufficient funds (NSF), or the account has been closed. In the computer age, bad checks also include counterfeit checks that are written on nonexistent accounts.

Bounced checks include those written against insufficient funds due to inaccurate accounting by the check writer, as well as those from check writers who knew the funds were not present but still wrote the checks. In most criminal jurisdictions, there is a presumption of inaccurate accounting by the check writer, and the check writer is given a prescribed time period (usually 10 days) to "make the check good" by paying both the face value of the check as well as a processing fee, usually capped by legislation. After the prescribed time period for bounced checks, or for checks written on closed accounts, there is no longer a presumption of inaccurate accounting and the matter accelerates to the threshold of being a criminal act. The recipient of a check in this situation must supply to the police proof of

notification to the check writer (certified mail with signed receipt) of the failure of the check to originally clear, a statement of nonpayment; or in the case of a closed account, proof that the account is closed, usually indicated on the check by the bank that refused to honor the instrument. Criminal prosecution is often deferred if, after being advised of the pending charge(s) by either police or the prosecutor, the check writer pays the face amount of the check, the prescribed processing, and possibly a fee added by the jurisdiction. If payment is not made, criminal charges can proceed forward.

Other examples of bad checks include stolen checks, counterfeit checks, and check-washing. Stolen checks refer to checks that have been stolen from the check-writer (from a mailbox, house, or wallet) and have been presented to others for payment. Due to lax check-acceptance policies in some operations, checks are accepted for payment without verifying that the person writing the check is the person listed on the check. In some cases, the theft of the checks is not realized until the first 10-day letter arrives. Counterfeit checks refer to checks that have been produced by nonlegitimate sources, and are encoded with either real or fictitious account numbers. In this situation, checks with real account numbers are originally honored but then later challenged as fraudulent by the account holder, who then files an affidavit of forgery with both the bank

and the police. Checks encoded with fictitious accounts cannot be honored as there is no account for the funds to be drawn from.

Check-washing refers to a process by which individuals have obtained previously written checks (often from outgoing mail) and use chemical agents to erase some of the written information (payee, dollar amount, or signature) on the check. The altered checks can now be passed, often with the aid of fraudulent identification cards. Annual estimates of loss by check alteration/check washing have been reported as high as \$815 million.

The number of bad checks accepted as payment by business operations can be reduced through the implementation of various secondary internal control policies. These policies include the requirement of valid identification, preferably identification issued by a governmental body; use of a check-validation system (a private service that tracks bad checks), and local registries of formerly received bad checks. Other policies often include: dollar limits, management approval, verification with a local bank branch, and inkless thumbprints.

#### SEE ALSO

check kiting; bank fraud; forgery; counterfeiting.

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## **bait-and-switch**

BAIT-AND-SWITCH REFERS TO fraudulent advertising committed by retailers to lure potential customers into their place of business. The Federal Trade Commission (FTC) defines bait-and-switch advertising as: "an alluring but insincere offer to sell a product or service the advertiser does not intend or want to sell."

The true intent of the advertising is to steer the consumer to a product other than the one listed in the advertisement, which usually generates a higher

profit margin to the retailer as well as costs the consumer more.

An example of bait-and-switch advertising is: ABC Computers advertises a \$399 complete computer system for sale; upon arrival to the retail location the consumer makes reference to the advertisement; the salesperson attempts to steer the consumer to another product through various methods ("just sold last one; all remaining units are damaged; product has incurred a large number of customer complaints; a leading consumer guide has just published a disparaging review") and refers the consumer to another product. The other product generally will cost more, and incidentally produce more profit to the retailer. In this scenario, it is assumed the retailer had no intent of selling the originally advertised merchandise, only using the lure of the pricing as bait to bring the potential consumer to the store, giving the salesperson an opportunity to convince the consumer she is better off purchasing the newly recommended merchandise.

The bait-and-switch con has historically been identified with certain industries, that is, electronics, automotive dealerships, furniture stores, and similar businesses. In many cases, the originally advertised prices were so low that alert consumers should have been wary of the offers. Both the draw of the incredible prices and the verbal skills of the salesperson are required to successfully complete the bait-and-switch process. If the salesperson is unable to steer the consumer away from the advertised merchandise to the merchandise the retailer desires to sell, then the scam has failed.

Some retail operations employ the use of shills. These are persons posing as other customers to assist in steering the consumer away from the advertised merchandise; through subterfuge such as "returning" their purchase and complaining loudly of their dissatisfaction with the advertised merchandise; or praising the salesperson for advising them of the recommended merchandise (of which they are so satisfied). Some retail operations employ salespersons more for their abilities to steer consumers than for their knowledge of the merchandise or their customer service skills.

Consumers who become aware that a bait-and-switch advertising scheme is being conducted can contact the local state attorney's office or the Federal Trade Commission (FTC), and provide a copy of the advertisement in question, as well as a description of what transpired at the retail operation.

Bait-and-switch schemes can also occur with services, that is, telephone, carpet cleaning, and home repair sales industries and are especially targeted to senior or non-English speaking populations.

#### SEE ALSO

scams; advertising fraud; Federal Trade Commission; Better Business Bureau.

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## Bakker, Jim and Tammy

JIM BAKKER'S FALL from a man of God to a man of fraud marked one of the largest religious swindles in history. Bakker, born in Muskegon, Michigan, in 1940, sowed his share of wild oats as a youth but eventually settled down to study the ministry. Inspired by an Oral Roberts's revival meeting, Bakker decided to pursue the profitable combination of religion and show business.

In the early 1960s, Bakker, along with his wife Tammy Faye (who was easily recognized by her liberal use of make-up and colorful eye shadow), worked with Pat Robertson on the Christian Broadcasting Network (CBN) and developed a successful children's show.

After an acrimonious break from CBN, the Bakkers partnered with Paul Crouch and the Trinity Broadcasting Network to air a daily talk show hosted by the husband-wife team called "Praise the Lord" (PTL). After a falling-out with Crouch, the Bakkers transformed PTL (now tagged People that Love) into a late-night, talk-show program in 1974. Within two years, the PTL show was being broadcast on 70 commercial stations and 20 cable services, and boasted more than 13 million viewers. The Bakkers also owned a 2,300-acre Christian theme park in Charlotte, North Carolina, that grossed \$130 million annually.

The ministry continued to grow, despite an uncomfortable and often hostile relationship with the

Federal Communications Commission (FCC) over improper financial practices. The first large-scale scandal occurred in 1979 after PTL raised \$350,000 to upgrade its overseas television and diverted the money to pay the Bakkers' personal bills.

The FCC's attempt to prosecute resulted only in administrative sanctions. The Bakkers attracted an even higher level of attention after additional rumors of wrongdoing emerged in 1987. Jim Bakker admitted having a one-night sexual encounter with 21-year-old Jessica Hahn, a former church secretary. Hahn's claim of sexual misconduct resulted in a \$265,000 pay-off and PTL was now dubbed "Pay the Lady."

Tammy Faye Bakker's drug dependency also became public, and meanwhile the Internal Revenue Service (IRS) revoked PTL's tax-exempt status. In the wake of the scandals, Jim Bakker resigned from PTL and was defrocked by the Assemblies of God Church. In 1988, Jim Bakker was charged with diverting millions of dollars from the PTL ministry to his personal use.

As details became public, the sordid particulars of the couple's extravagant lifestyle shocked the religious and secular worlds. The Bakkers' accumulated assets included: a house in Palm Desert, California, valued at \$600,000; a house in Gatlinburg, Tennessee, renovated at a cost of \$340,000; a \$600,000 condominium in Florida with \$60,000 worth of gold fixtures; a \$500,000 house in Palm Springs, California; a collection of Rolex watches; three Mercedes; his and hers Rolls Royces; a \$6,000 playhouse for their children; and an air-conditioned doghouse for Tammy's Saint Bernard dog.

Jim Bakker used his television show and direct-mail advertisements to induce followers to become life-time lodging partners in the Heritage USA theme park. A "gift" of \$1,000, for example, allowed a member to stay free in the Grand Hotel for four days and enjoy a vacation of religious activities. Bakker sold 66,683 fully paid partnerships in the Grand Hotel though he originally had limited the lodging sales to 25,000. The partnership programs for the Grand Hotel ranged from \$500 to \$10,000 and netted approximately \$67 million for the Bakkers.

Over half the money collected for the hotel was used to cover daily operating expenses, including excessive compensation and perks to the Bakkers. Just over half of the monies raised were used for construction and no funds were saved to cover the



*Jim Bakker, founder of the PTL Network, pauses with reflection, during an interview.*



*Tammy Faye Messner (formerly Bakker) poses with her dog, Tuppins III, at a book-signing.*

cost of future life-time lodging. In a similar scheme, almost \$70,000 worth of paid partnerships was sold for the never-built Towers Hotel.

The Bakker scandal represented the largest consumer fraud case ever prosecuted for federal wire- and mail-fraud violations. Prosecutors argued that Jim Bakker had engaged in a massive scheme to oversell life-time partnership packages. A 28-page indictment included eight counts of mail fraud, 15 counts of wire-fraud use of telephone and television, and one count of conspiracy to commit wire and mail fraud with partner, Richard Dortch. The 1989 trial disclosed Jim Bakker had fraudulently raised more than \$158 million from 1984 through 1987. He was convicted on 24 counts of fraud, fined \$500,000, and sentenced to 45 years in prison by a U.S. federal district court judge.

The sentence, labeled as overly harsh, was appealed and reduced to 18 years. The couple divorced in 1992 and Tammy Faye married Jim's best friend. Bakker was released from prison to a halfway house in 1994. As a result of the Bakker scandal, the National Religious Broadcasters established a new code of ethics that defined proper moral and financial standards for television ministers.

#### SEE ALSO

wire fraud; mail fraud; religious fraud.

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## Banco Ambrosiano

IN 1982, Banco Ambrosiano, then Italy's largest private bank, collapsed with estimated debts of \$1.3 billion. Ambrosiano had come close to collapsing in May 1981 when the bank's president, Roberto Calvi, was convicted of illegally exporting billions of lire and was sentenced to four years' imprisonment.

Calvi was bailed-out pending an appeal after spending a short time in jail. When it was revealed that Calvi was a member of the P2 masonic lodge, press speculation further undermined confidence in Ambrosiano.

The Vatican, which owned a large number of shares in Ambrosiano, took the unprecedented step



of issuing letters reassuring creditors that the Vatican would assume the bank's liabilities. However, the letters did not halt the official investigation of Ambrosiano's affairs. In June 1982, the Italian Treasury dissolved the bank's administration and made the Bank of Italy a temporary commissioner when the investigators discovered a \$1.3 billion "hole" in Ambrosiano's accounts. Further investigation revealed that Calvi had worked closely with Archbishop Paul Casimir Marcinkus, head of the Institute of Religious Works, known by its Italian initials IOR, to channel Vatican funds into a network of secret offshore accounts, creating a Bahamian subsidiary of Banco Ambrosiano and a series of Vatican-owned shell companies in Nicaragua, Panama, and Peru.

Ambrosiano booked loans of millions of dollars to these dummy companies. With or without the Vatican's blessing, Calvi used the shell companies to make other investments such as buying control of Banco Ambrosiano and the Rizzoli media empire. The "hole" in the accounts came about when these investments collapsed, wiping out the loans along with interest charges. Calvi fled Italy when the Italian authorities discovered the extent of the bank's losses. Several days later, his dead body was found hanging under London's Blackfriars Bridge with 11 pounds of bricks and \$15,000 in his pockets. His secretary had killed herself the day before.

Calvi's death, the death of his secretary, and the refusal of the Vatican to cooperate with the Italian authorities prevented investigators from fully unravelling Ambrosiano's financial network. Although the investigation revealed that the IOR held a controlling interest in the bank, the Vatican denied legal responsibility for the collapse of Ambrosiano arguing that the shell companies were nominally owned by the IOR. However, the Vatican admitted "moral involvement" in the collapse and paid \$241 million to Ambrosiano's creditors in 1984.

The collapse of the bank and the circumstances surrounding Calvi's death continue to puzzle British and Italian police. An inquest in London recorded a suicide in July 1982, but a second inquest in July 1983 delivered an open conclusion, while a civil court in Milan concluded that Calvi was murdered.

In 1997, Italian prosecutors began to investigate Calvi's death once more. In July 2003, the pros-

ecutors concluded that the Mafia murdered Calvi to punish him for misappropriating Mafia funds and to prevent him from blackmailing powerful figures in Italian society. The prosecutors went on to name four people suspected of murdering Calvi. Two months later, the City of London Police announced that they had reopened the investigation into Calvi's death.

#### SEE ALSO

Vatican Bank; Italy; organized crime.

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## bank fraud

**BANK FRAUD** IS A SPECIALIZED type of criminal deception that involves customers, employees of the bank, or others who knowingly execute, or attempt execute a scheme to obtain money, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations, or promises.

A federally chartered or insured financial institution is a bank with deposits insured by the Federal Deposit Insurance Corporation (FDIC), or a credit union with accounts insured by the National Credit Union Administration Board, or a federal home loan bank.

On October 12, 1984, President Ronald Reagan signed into law the Comprehensive Crime Control Act of 1984. It was designed to fill an obvious gap in the federal criminal laws by enacting the first true federal bank fraud statute. The enactment of Sec-

tion 1344 of the law was the product of growing concern over the inability of federal prosecutors to reach sophisticated financial criminals with antiquated statutes, many of which were enacted more than 50 years ago. Congressional concern over this problem was fueled by the bank failures of the early 1980s, and claims by prosecutors that several Supreme Court decisions interpreting federal criminal laws have hampered prosecutions.

The absence of a federal statute applicable to certain types of fraudulent activities does not mean that those activities will escape prosecution; state laws prohibit virtually all kinds of financial fraud. The superior resources of federal prosecutors, and the arguably greater federal interest in federally insured financial institutions has, however, traditionally meant that federal prosecutors pursue these offenses.

Prosecutors have complained in particular about Supreme Court decisions limiting the reach of those federal criminal statutes that prohibit mail fraud and the making of false statements to banks. The false statement statute (Section 1014) has historically been utilized by the Justice Department to prosecute check-kiting and other similar schemes designed to induce the advancing of money or credit based on a check known by the customer to be drawn on insufficient funds. The government's theory was that the check was implicitly a statement to the bank that there were sufficient funds on deposit to cover the check and that the statement was false. This theory of prosecution was foreclosed, however, by the Supreme Court's 1982 decision in *Williams v. United States*, which held that check-kiting, or deliberately drawing a check on insufficient funds, is not a violation of Section 1014 because the check is not a statement but merely an order to pay funds. The impact of *Williams* was to terminate a number of federal criminal investigations. The new bank fraud statute may permit federal prosecution of many of these acts, especially those involving check-kiting.

Bank frauds have also traditionally been prosecuted as violations of the federal mail fraud or wire fraud statutes when the prosecutors could prove that the federal mail or wire communications were used to execute the fraudulent scheme. Federal jurisdiction over the crime is predicated on the use of the mail or wire communications. This approach has been restricted by the Supreme Court's decisions in *United States v. Maze*, which held that the

mail fraud statute must be construed to apply only where the mail is used for the purpose of executing the scheme or artifice to defraud, and is not applicable to every case where the mail is utilized at some point in the scheme. Another problem for prosecutors is that the rise of private courier services means that businesses are making less use of the mails and wires, further reducing the use of these statutes.

These developments, coupled with the perception that financial fraud had become too sophisticated for the then-existing statutes prohibiting it, convinced Congress to address the problem directly and enact a specific bank fraud statute that would allow the government to prosecute a much broader spectrum of bank fraud. Although the decision to enact a comprehensive bank fraud statute has significant federal implication, because it shifts the primary law enforcement role for bank fraud from the states to the federal government, this issue has received very little attention.

## COST AND FORMS OF BANK FRAUD

How significant are bank losses due to fraud? Fraud losses in the financial industry are difficult to determine. Although estimates of fraud committed by bank officials in the United States may be unreliable, some analysts suggest the loss of savings and loan fraud perpetrated during the 1980s and 1990s alone cost tax payers over \$1 trillion.

For the period of April 1, 1996 through September 30, 2002, the Federal Bureau of Investigation (FBI) received 207,051 Suspicious Activity Reports (SARs) for criminal activity related to bank fraud: check fraud, check-kiting, counterfeit checks, and counterfeit negotiable instruments. These fraudulent activities accounted for 47 percent of the 436,655 SARs filed by U.S. financial institutions (excluding Bank Secrecy Act violations), and equaled approximately \$7 billion in losses.

Bank fraud takes many forms. In most instances, bank fraud involves small amounts of money and a relatively simple transaction. The most common bank fraud committed by outsiders is check fraud. Check fraud is the forgery, alteration, counterfeiting, or knowing issuance of a check on an account that has been closed or has insufficient funds to cover the amount for which the check was written.

Closed-account fraud relies upon the time that it takes a bank transaction to be processed or "float

time.” The float time offers a window of opportunity for the criminal to defraud the financial institution. An act similar to closed-account fraud is check-kiting. Check kiting requires multiple bank accounts and the movement of fictitious funds between those multiple bank accounts. Like closed-account fraud, the check-kiter also takes advantage of the time necessary for a bank transaction to be processed in order to create fraudulent balances. A check-kiter will deposit a check drawn on one bank into a second bank without having adequate funds in the first account to cover the check. When the deposit is made, the second bank grants the depositor credit, allowing the customer to draw checks against funds not yet collected by the bank. The check-kiter then writes a check on the second bank and deposits into the first bank to cover the original check. The perpetrator’s plan is to continue writing checks between accounts to cover insufficient funds.

Another relatively simple type of fraud involves opening a new bank account using false identification. After depositing altered or counterfeited checks into the account, the offender then makes withdrawals for a large portion of the account balance before the bank realizes it has been victimized.

The process of altering a check is another form of check fraud. Chemical modification to checks or check-washing is one of the most popular forms of alteration. Check-washers use acid-based household chemical solutions to alter or erase particular pieces of information on the checks, such as payee name and payment amount. Check-washers may then add new information to the checks using a typewriter, laser printer, or other means to make the checks payable to themselves or to co-conspirators while also increasing the amount payable.

## BANK INSIDER FRAUD

Insider abuse often involves defrauding the bank, and is a technical term that refers to a wide range of misconduct by officers, directors, and insiders of financial institutions committed with the intent to enrich themselves without regard for the safety and soundness of the institution they control, in violation of civil banking laws and regulations and, perhaps, also in violation of criminal banking laws. The term *criminal misconduct* refers strictly to criminal acts committed by such insiders against the institutions they control. Thus, insider abuse does not

necessarily involve criminal misconduct. However, there is usually a very thin line between insider abuse and bank fraud. The difference between fraud, which is illegal, and abuse, which is legal but not good, is a matter of interpretation. It is up to a jury to decide which side of the line the accused is on; and the so-called bad guys frequently get off, despite the best efforts of the FBI, regulators, and others. Equally important, insider abuse and fraud lead to unsafe or unsound banking practices, such as extending credit that is inadequately secured, failing to maintain internal controls, and paying excessive cash dividends.

Self-dealing is a common form of insider abuse. It refers to insiders putting their own self-interest above the interest of the bank. One form of self-dealing is when an insider uses her authority to grant loans to herself, or a related business, at preferential terms or using lower credit standards, with the intent of making profit in that business. For example, banking regulators sued the National Bank of Georgia, Calhoun First National Bank, and T. Bertram (Bert) Lance, an insider, for engaging in certain unsafe and unsound banking practices that violated federal securities laws.

Lance was the former Jimmy Carter administration budget director who resigned that post because of his banking practices. The complaint alleged that credit (loans and overdrafts) was extended to Lance, his relatives, and his friends on preferential terms and without regard to their creditworthiness. The extension of the credits caused liquidity problems at Calhoun bank.

To solve the problems, Calhoun bank transferred troubled loans to other banks, but Calhoun bank concealed the transfers by making misleading entries in its books. The loans were not reflected on Calhoun’s financial statements, and no adjustment was made to the provision for loan losses for some of the transactions. The result was that earnings and assets were overstated, and the bank failed to disclose its true financial state to banking regulators and investors.

Bank failures of the late 1980s and early 1990s resulted from bank fraud in large commercial and real-estate transactions, and they frequently involved insider participation. The five most common types of schemes that result in major frauds include: nominee loans, double-pledging of collateral, reciprocal loan arrangements, land flips, and linked financing.



One form of bank fraud can include identity theft to gain access to bank funds with false identification.

*Nominee loans.* These are loans obtained by one person on behalf of another undisclosed person. The nominee, or “straw borrower,” may have no involvement in the loan transaction other than to obtain the funds and pass them on to someone else who does not want their own identity known.

*Double-pledging of collateral.* The same collateral is used at two or more financial institutions to obtain loans. The lenders are unaware that the collateral is pledged on another loan. The combined amount of the loans exceeds the value of the collateral.

*Reciprocal loan arrangements.* These are loans made between insiders in different financial institutions that lend funds to each other. A variant of this device is to sell loans to other institutions with the agreement to buy loans from that institution. The purpose of such agreements is to conceal the loans or sales from bank examiners.

*Land flips.* This refers to the transfer of land between related parties in order to fraudulently inflate the value of the underlying property. The land with the inflated values is used as collateral for loans. The amount of the loans frequently exceeds the actual value of the underlying property.

*Linked financing.* Large amounts of funds are deposited in a financial institution, using brokered deposits or some other means, with the understanding that the institution will make a loan conditioned on the deposit. The loans may be used to finance land flips or other types of deals.

Some of these schemes, such as linked financing and land flips, are not necessarily illegal by themselves. However, they usually occur in connection with willful misapplication of funds, making false statements, willfully overvaluing property, and other illegal activities.

Although these types of transactions are presented separately, they often occur in combination. For example, large-scale fraud involving real estate requires two misrepresentations. The first essential misrepresentation is that the value of the property is inflated. The second misrepresentation concerns the creditworthiness of borrowers. The crooks misrepresent their own creditworthiness, the creditworthiness of the buyers they control, and the value of the properties by using false income-tax returns and false financial statements. Property values are usually inflated by using a “double escrow” or a “straw buyer.”

In a double escrow, the same property is sold simultaneously to two separate parties controlled by the perpetrator. The first transaction is from a legitimate seller at a fair market price to a buyer who is controlled by the perpetrator. The second sale is from the first buyer to the second, both of whom are controlled by the perpetrator. The second sale is made at two or three times the fair market price. In some cases the value is inflated as much as 20-fold by using improper appraisals. This type of operation is also used in connection with a land flip. If a straw buyer is used, the straw buyer buys the property from the legitimate seller at the fair market price. Then the property is sold again, but at a higher price to a buyer who will qualify for a loan on the property at an inflated value.

To obtain inflated appraised property values, the perpetrators hire real estate appraisers from distant locations who want to increase their fee income, or who may also be criminals. The appraisers, who are not familiar with the property, are provided with false information about the comparable worth of properties in the area. To illustrate this process, one bank loaned over \$54 million on an office complex and relied on a borrower-ordered appraisal. The appraisal did not consider that more than one-

half of the rentable space was leased at rates that were 50 percent below the current market prices, or that occupancy levels were low in nearby comparable properties due to overbuilding. The result of such actions is faulty and inflated appraised values.

Then “loan packages,” including financial statements, appraisals, and other information are presented to prospective buyers by “loan brokers” or others pretending to be independent and objective third parties. The buyers of the overvalued real estate are individuals, limited partnerships, or financial institutions that rely on the honesty and thoroughness of the independent and objective third parties. Rarely do buyers do their own credit analysis or appraisals, especially if the property is at a distant location.

### NEW FRAUD OPPORTUNITIES

As computers proliferate at work and home, there are more opportunities for criminals to use computers to facilitate check and credit-card fraud. The use of relatively inexpensive computers, scanners, and printers, with capabilities often referred to as desktop publishing, has enhanced the ability of criminals to manufacture their own brand of counterfeit checks. Computers loaded with sophisticated graphics capabilities can be purchased from most computer and office-supply stores. Counterfeiters, with the aid of computers, can duplicate corporate and payroll checks, travelers’ checks, credit cards, certified bank checks, money orders, currency, and other negotiable instruments, as well as personal identification such as drivers’ licenses and social security cards.

According to the American Bankers Association, the most common type of check fraud in 1999 was forgery. More than one-third of fraud cases and fraud losses were attributed to forgery. According to a study conducted by Ernst & Young, 500 million checks are forged annually in the United States, resulting in losses of \$10 billion.

The burgeoning use of the internet and advanced technology, coupled with increased investment and expansion, has intensified competition within the financial sector. With lower costs of information-processing, legitimate companies have found it profitable to specialize in data-mining, data-warehousing, and information brokerage. This wealth of available personal information creates a target-rich environment for today’s sophisticated

criminals, many of whom are organized and operate across international borders.

Simply stated, identity crime is the theft or misuse of an individual’s personal or financial identifiers in order to gain something of value or to facilitate other criminal activity. Types of identity crime often involve financial loss to a bank. Identity crimes are often associated with other crimes such as narcotics, organized crime, mail fraud, money laundering, immigration fraud, and terrorism.

### MONEY LAUNDERING

In addition to identity theft, improved technology has benefited criminals attempting to defraud banks through money-laundering. Money-laundering is a frequently used criminal scheme in which illicit cash is introduced into financial systems by usurping bank-reporting requirements. The U.S. Treasury Department views money-laundering as the cornerstone of financial operations among international



*Five hundred million checks are forged annually in the United States resulting in losses of \$10 billion.*

organized crime groups. Because most criminal income is in the form of cash, these profits are unusable in a contemporary, cashless banking system. Criminal organizations move their cash profits through financial institutions to legitimize the money and provide them access to the funds. Money-laundering is classified as a type of banking fraud because launderers not only avoid bank reporting regulations but, by using deceit, also fraudulently convert illicit cash profits into legitimate assets. Their goals are to subvert bank-reporting procedures, disguise the source of the assets, and introduce the cash into cashless banking channels.

There are several methods of introducing the illicit cash into legitimate financial circles. There are four common money-laundering techniques: bank methods, smurfing, currency exchanges, and double-invoicing.

Bank methods include various exchange transactions in which cash is converted by currency trading, exchange for treasury bills, bank drafts, letters of credit, travelers' checks, cashiers' checks, bank wire transfers, or other noncash monetary instruments. This conversion method is effective if the launderer is able to change cash into any noncash financial instrument which can be used in deposit or spending transactions.

Smurfing is a process of making numerous cash deposits into several bank accounts. This laundering tactic depends on depositing quantities of cash just under the minimum amount banks are required to report to the Treasury Department. By making deposits into numerous bank accounts in a short period of time, smurfing techniques launder a significant amount of cash without being detected by bank transaction reporting.

To avoid traditional financial institutions, money launderers often use currency exchanges to convert U.S. cash into foreign currency, which is later processed through banks. This ploy establishes a false corporation to receive the converted cash in foreign jurisdictions. Once the cash is converted into foreign currency, it can be introduced into legitimate banking channels and utilized by the money launderer.

In another strategy, double-invoicing disguises financial gains by invoicing a domestic or foreign commercial subsidiary at an inflated price for merchandise and depositing the profits. Thus, the source of the funds is hidden by manipulating the documentation of business income.

In addition to these four laundering methods, criminal organizations purchase and operate their own banks to mask money-laundering activities by failing to comply with bank transaction reporting laws. This is the most difficult money-laundering method to detect.

Lastly, perhaps the most unsophisticated, yet effective, money-laundering method is to transport physically large quantities of cash outside of the United States to deposit in foreign bank accounts, in violation of U.S. currency reporting laws. According to U.S. Treasury estimates, these laundering techniques are responsible for \$100 billion in U.S. illegal drug profits passing through financial institutions.

Since the 1992 peak of the savings and loan crisis, the FBI has been able to refocus its investigative efforts from failed financial institution cases to other high-priority cases. At the close of fiscal year 2002, the total number of pending financial institution investigations in the FBI was 7,305. Of this total, 71 failure cases, or less than 1 percent, involved criminal activity related to a financial institution. This statistic reflects a 91 percent reduction in failure investigations since the July 1992 peak of 758 cases.

However, as the number of failure investigations has declined, the number of major financial institution fraud investigations has remained substantial. Since then, external fraud schemes have replaced insider abuse as the dominant financial institution fraud problem confronting financial institutions. In many instances, the international aspects associated with many of these schemes have increased the complexity and severity of the fraud being committed.

#### SEE ALSO

check-kiting; money-laundering; land flips; forgery; counterfeiting.

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## Bank of Credit and Commerce International

ON JULY 5, 1991, the Bank of England and Luxembourg and Cayman Islands authorities froze the deposits of the Bank of Credit and Commerce International (BCCI) and closed its branches. BCCI had offices in 70 countries and 14,000 employees. More important, the bank had a negative value of £7 billion and estimated losses of £12 billion. Founded in 1972 by the Pakistani banker Agha Hasan Abedi, BCCI had been mired in scandal since a U.S. federal grand jury in Tampa, Florida, on October 4, 1988, indicted the bank and 10 bank executives for laundering drug money. Pundits began to call BCCI the Bank of Cocaine and Criminals International.

The investigations leading to the court case prompted the Bank of England and other interested national banking authorities to form a college of regulators to monitor BCCI in May 1988. However, it took three years and two months for the Bank of England and other interested parties to decide to close the bank. The Bank of England's tardy response to this and other indications of fraudulent activity at BCCI was heavily criticized by an official inquiry in Britain under the chairmanship of Lord Chief Justice Bingham, and a subcommittee of the U.S. Senate Committee on Foreign Relations under the chairmanship of Senator John Kerry (D-MA). In 2001, the UK House of Lords took the unprecedented step of granting BCCI's creditors to sue the Bank of England for willful misconduct.

Abedi formed BCCI in 1972 with the relatively small amount of capital of \$2.5 million. The Bank of America had a 25 percent stake in the new bank, which was incorporated in Luxembourg. Offices were also opened in UK, Oman, and the United

Arab Emirates. London was, however, the *de facto* headquarters of BCCI. In public, Abedi's stated aim was to create "a world bank, a global bank for the Third World." BCCI made a series of vast loans to a small number of respectable and powerful Middle Eastern and Pakistani businessmen and leaders, including the ruler of Abu Dhabi, and president of the United Arab Emirates Zayed bin Sultan al-Nahyan.

These loans worried the Bank of America and were perhaps the downfall of BCCI. During the 1970s, the bank made a series of enormous loans to the Gulf Group, a shipping firm controlled by the Gokal family. When Gulf appeared close to bankruptcy in 1980, BCCI poured more money into the firm to keep it afloat and disguise the bank's exposure from regulatory authorities who might close it down. Other bad loans and attempts to expand the bank's operations into North America added to the bank's woes. Throughout the 1980s, bank executives plundered accounts to conceal massive losses. The bank also sought new customers to balance the books. In 1983, BCCI bought a Colombian bank with branches in Medellin and Cali.

The authorities received several warnings of the fraudulent activities of the bank. In 1975, U.S. authorities stopped BCCI from taking over two New York banks. Two years later, U.S. authorities blocked another attempt to acquire a U.S. bank, Financial General Bankshares. In 1985, the Bank of England received an anonymous letter alerting them to the bank fraud. In 1988, BCCI was indicted for money-laundering in Florida.

In 1990, Price Waterhouse, BCCI's sole auditor since 1988, published two reports indicating large-scale fraud at the bank. The Bank of England admitted receiving the first indication of fraudulent activity at BCCI in January 1991. The spectacular failure of the Bank of England to supervise BCCI has prompted conspiracy theorists to speculate that the British intelligence community used BCCI to channel funds to agents and gather intelligence on drug barons and terrorists.

### SEE ALSO

bank fraud; accounting fraud; money laundering; United Kingdom.

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## Bank Secrecy Act

THE BANK SECRECY ACT (BSA, Public Law 91-508), signed by President Richard Nixon in 1970, was formulated in order to detect illegal activities by tracking suspicious financial transactions. Also known as the Currency and Foreign Transactions Reporting Act, the BSA is a major crime-fighting tool used by different U.S. government agencies, including the Internal Revenue Service (IRS) and the Federal Bureau of Investigation (FBI).

Since the enactment of the BSA, it has been amended multiple times. These substantial modifications to the BSA include the Anti-Drug Abuse Act of 1986, which contained the Money Laundering Control Act of 1986, and the Money Laundering Suppression Act of 1994. These acts enhanced the enforcement effectiveness of the law by making money-laundering a criminal activity, requiring researchers to develop more successful examination methods, and calling for more examiner training in order to better identify suspicious schemes at financial institutions.

In its current form, the BSA requires that all financial institutions comply with certain provisions and that banking officials formulate internal compliance programs in order to do so. In its simplest form, an internal compliance program must be written, approved by the directors, and include a structure of internal controls to guarantee compliance with the BSA, external or internal auditing of the institution's compliance, daily supervision by a specified person, and training for the money-tracking personnel. The internal controls are required by the BSA to be comprehensive and effective. They

must detail the monitoring of opening and closing accounts and transactions-reporting procedures. Senior management at a financial institution must be updated regularly with compliance and audit reports in order to ensure their knowledge of compliance. Also, the BSA must be an integral factor of a job offer's description and it has to be one of the conditions of employment.

Testing by external or internal auditors is an essential check to ensure that there are no lapses in compliance. Auditors are required by the BSA to monitor a financial institution's internal compliance program and evaluate the employee's knowledge concerning BSA requirements, the quality of the BSA training program, and observe the bank's ability to identify suspicious activity.

The designation of a compliance officer and the establishment and maintenance of a BSA training program are two other components of an internal compliance program. A qualified employee directly employed by the financial institution is required to oversee all the components of the BSA internal compliance program, including the training program. Training must involve all relevant banking personnel, whether an employee is a bank teller or a bank president. It is essential that the training program be updated often to address new bank-crime schemes and new regulations.

According to the BSA, there are five reporting requirements with which banks must comply. These reports include an IRS form detailing any transaction amounting to over \$10,000, a U.S. Customs form for anyone who transports, mails, or receives foreign currency over \$10,000, and a Department of Treasury form with a list of a customer's foreign accounts that exceed \$10,000. The Suspicious Activity Report (SAR) is another form, which must be submitted to the Department of Treasury that details any transaction, which is deemed to be suspicious. Also, an exemption report must be filed every other year in order to gain authorization for an exempt customer.

Guidelines are set for record-keeping as well. Banks must keep records of each transaction between \$3,000, \$10,000, and higher, along with identity verification of the customer. Also, records of fund transfers between banks of any amount above \$3,000 must be kept and reported.

To help overcome these bookkeeping tasks, a number of computer programs were created, including the Currency Reporting System, which



records data and automatically produces the necessary IRS forms, and the Wire Transfer Control System, which is able to interface with other federal bank programs and generate the reports required by the Department of Treasury.

Enforcement of the BSA really depends upon bank employees' ability to recognize and report suspicious activities and illegal conduct. BSA training guides stipulate numerous signals of foul play. For example, suspicious activities include opening several accounts and constantly transferring substantial amounts of money; frequent, large transactions in cash; complete repayment of a loan with no explanation as to the source of the repaid money; large wire transfers from foreigners; frequent exchanges of small bills for large bills in substantial amounts; and the purchase of cashier's checks or money orders with large amounts of cash. Consequently, the BSA requires that banking officials work closely with federal investigations and daily confront problems like drug-trafficking and money-laundering.

#### SEE ALSO

money laundering; drug trafficking; check kiting; bank fraud.

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## Banker's Trust

EMPLOYEES OF Banker's Trust Company took advantage of derivatives trading to steal from such customers as multinational consumer goods firm Procter & Gamble, and greeting card company Gibson Greetings from 1991 to 1994.

The situation led to reforms in the derivatives market and, by forcing Banker's Trust to reorient its business away from derivatives trading, contributed to its takeover by Deutsche Bank. Derivatives are a

family of complicated transactions used either to hedge the risk of a financial market or index, or to speculate upon it. As such, the transactions involve a high degree of risk and provide salespeople with high profits.

Banker's Trust employees did not fully explain derivatives to their customers. Bank employees concentrated primarily on the New York interest rate desk and the New York corporate desk exploited weaknesses in the derivatives business for their own purposes.

In one case, a trader used his facility with mathematics to develop a formula for a leveraged derivative product that concealed the amount of leverage embedded in the product. Attempts by the bank's internal control departments to enforce appropriate standards, such as determining if a transaction was suitable for a customer, were suppressed by senior management. The bank executives, including chairman Charles S. Sanford, Jr., proved more interested in marketing lucrative derivatives than in protecting the financial well-being of its clients.

When exposed, Banker's Trust fired the guilty employees who still remained with the firm. It settled lawsuits with its defrauded customers and four regulatory agencies. These agencies, the Commodity Futures Trading Commission, Federal Reserve, New York State Banking Department, and the Securities and Exchange Commission, subsequently issued a report recommending changes in the derivatives business.

Many of the recommendations have become standard operating procedure in the industry, including the practice of keeping written policy manuals and requiring that non-English speaking customers receive adequate disclosure of the terms and risks of derivatives in a language that they can clearly understand. The agencies also acknowledged that Banker's Trust Company had not made any institutional effort to defraud, mislead, or take advantage of its banking customers and that many of its employees had acted properly.

#### SEE ALSO

bank fraud; accounting fraud; securities fraud; Securities and Exchange Commission.

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## **bankruptcy fraud**

BANKRUPTCY REFERS to the act of declaring one is incapable of paying debts. The laws relating to bankruptcy were designed to protect both individuals and corporations in the event that a financial disaster were to strike; more specifically, the laws were developed to prevent people and companies from losing all of their property. Occasionally, however, a debtor will fraudulently claim bankruptcy. The debtor may attempt to conceal her assets, she may lie about debt, or she may file multiple claims of bankruptcy in an attempt to defraud creditors.

Historically, the filing of a claim of bankruptcy imparted a sense of failure on the part of the debtor. However, as the procedure has become more established in society there has been a 500 percent increase in bankruptcy filings. Of this number, 10 percent involve fraudulent claims. There are four commonly encountered fraud schemes: concealment of assets fraud, petition mills, multiple filing schemes, and bust-out schemes.

### **CONCEALMENT OF ASSETS FRAUD**

When a debtor files for bankruptcy he is required to list all assets so that creditors will have the opportunity to claim a share of the earnings from the sale of these assets. However, under this form of fraud, the debtor will intentionally neglect to list all assets. The criminal belief is that creditors cannot obtain payment from the sale of assets that are not known.

There are several variations of this scheme. In one variation, the debtor will transfer the assets she wishes to keep to the name and financial accounts of a family member who has good credit. Another variation involves the debtor hiding cash assets in accounts overseas and outside the legal jurisdiction of U.S.-based creditors.

Concealment of assets is the most commonly encountered form of bankruptcy fraud, with over

two-thirds of all fraudulent bankruptcy cases invoking variants of the scheme.

### **PETITION MILLS**

Petition mills take advantage of poor debtors who wish to save their homes. Under this form of fraud, a tenant will be contacted by an agency offering to work with the debtor's landlord to prevent eviction. The debtor then agrees to pay the agency for their services. Many times these agencies have no intention of contacting the landlord. Instead, the agency will take the personal information collected from the debtor and file bankruptcy without the tenants' knowledge. The tenant continues paying the agency, while the agency will extend the eviction process out over several months. By the time the tenant realizes that he has been duped, his credit has been destroyed, his bank account has been drained, and his home has been taken. These operations are seeing increased use in larger metropolitan and urban neighborhoods where the population consists of large numbers of poor people. Some petition mills operations also operate under the guise of credit-counseling services. The activities are similar, only the pretense changes.

Debtors are still charged for the services of the credit counselor who is filing bankruptcy in the debtor's name without permission, instead of working with creditors. In the end, when the scheme is discovered, the debtors will find that counselors have made their credit record worse, and that they have lost the money spent on counseling.

### **MULTIPLE FILINGS SCHEMES**

These operations work in much the same manner as the concealment of assets frauds. In both instances, the debtor declines to list all of her assets when she files for bankruptcy. Unlike concealment of assets, these operations are repeated multiple times in separate states. Individuals who engage in this form of fraud will travel from state to state filing bankruptcy claims in each state.

Many times the debtor will use her own personal identifying information, including: social security number, birth date, and name. However, when this information becomes unusable, the debtor will move to the use of illegally obtained information. By combining fraudulent bankruptcy skills with the skills of an identity thief, the debtor

can move from state to state filing bankruptcy claims in the names of unknowing victims.

## BUST OUT SCHEMES

Bust out schemes have long been a problem but have only recently been classified by many scholars as bankruptcy fraud. Historically, individuals who engaged in this type of activity were labeled as careless but not criminal; today, the same cannot be said. When an individual is engaged in a bust out scheme, he or she will apply for as much credit as possible and then fail to pay on any of the accounts. Once the debtor has maximized the number of credit accounts that can be offered, then he will file the bankruptcy claim with no intention of ever paying back the goods. Often, these activities involve buying luxury items that may not be reclaimed by creditors during the bankruptcy proceedings.

One of the most famous incidents of bankruptcy fraud involves the activities of Robert Brennan. Brennan was suspected of numerous financial crimes but was eventually convicted of bankruptcy fraud. During the mid-1990s, Brennan became involved in a scheme where it became apparent that he was going to owe the Securities and Exchange Commission (SEC) approximately \$75,000,000. To avoid losing everything, Brennan secured a large amount of liquid assets, including several million dollars worth of New York state bearer bonds and several hundred thousands of dollars worth of casino chips from the Mirage Casino. Eventually, investigators were able to track down Brennan's accounts and he was charged and convicted of bankruptcy fraud.

In response to the growing problem of bankruptcy fraud, numerous federal law enforcement agencies including the U.S. Secret Service, the Federal Bureau of Investigation, the United States Postal Inspection Service, and the Internal Revenue Service, have joined forces to begin actively prosecuting those who attempt to defraud creditors through bankruptcy fraud. Individuals who are found guilty of bankruptcy fraud may be sentenced to a fine of up to \$250,000 and a prison sentence of up to 5 years.

Individuals are also no longer the only ones being investigated by federal law enforcement. Corporations are now frequently investigated for their role in fraudulent bankruptcy-related activity. The emphasis on bankruptcy fraud has moved from a

reactive nature to that of a proactive nature. Several cooperative efforts among the various law enforcement agencies have resulted in large scale sting operations designed to deter others from committing bankruptcy fraud.

After all, one of the more commonly cited assumptions in handling white-collar crime investigations is the fact that the individuals committing the crime are more deliberate and are therefore more likely to be deterred by prosecution of others who are committing similar criminal acts. Whether this statement is true remains to be seen; however, reactive strategies have not worked and so there would appear to be little harm in subscribing to such a proactive strategy.

Another modification in the response to bankruptcy fraud is the focus on prosecuting accountants and other professionals in the financial industry. The theory being that these are the individuals who are responsible for large-scale increases in fraudulent bankruptcy claims. Individuals may not be familiar with how bankruptcy operates, but accountants and financial advisers who engage in bankruptcy fraud can encourage criminal activity. There are a large number of individuals who may file bankruptcy, but the number of these "one-timers" is far outweighed by the number of fraudulent claims that can come from bankruptcy fraud professionals.

## SEE ALSO

accounting fraud; stock fraud; Securities and Exchange Commission.

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## Barings Bank

ON SUNDAY, February 26, 1995, the banking world was stunned by the announcement that Barings Bank, Britain's oldest merchant bank, had collapsed. Barings owed £827 million on financial

derivatives contracts, but the bank's entire assets amounted to little over £540 million. Barings' exclusive clientele, which included the British Royal Family, stood to lose all the money they had invested in the bank. The fact that one trader at Barings' Singapore office had accumulated the losses revealed the bank's lack of effective internal controls, and undermined confidence in the "gentlemanly" capitalism practiced by traditional merchant banks.

## BARINGS HISTORY

Founded by Sir Francis Baring in 1762, Barings Bank was Britain's oldest merchant bank and had financed the Napoleonic Wars, the Louisiana Purchase, and the construction of the Erie Canal; managed French reparations after Napoleon's defeat at Waterloo; acted as agents for Imperial Russia and the U.S. federal government; and issued bonds for the Chinese and Japanese governments. In 1890, Barings Bank narrowly avoided collapse due to over-exposure in Latin America. The bank was less fortunate in 1995 when it found itself in a similar position in the Far East.

During the late 1980s and early 1990s, Barings expanded its brokering operations in Asia, particularly in Singapore. In 1987, Barings Securities Limited (BSL), the brokering arm of Barings, established Baring Securities Singapore Limited (BSS), opening an office in Singapore. Initially, BSS focused on trading in equities, but its volume of futures trading on the Singapore International Monetary Exchange (SIMEX) grew quickly. As BSS did not have a seat on the exchange, the firm had to pay commissions on its transactions. A decision was made to cut out the middle-man, buy a seat on the exchange, and hire futures traders. Senior managers authorized the futures traders to carry out futures and options transactions on behalf of clients, or the Barings group, and trade in Nikkei-225 futures contracts listed on the Osaka Securities Exchanges (OSE) and SIMEX, in order to profit by small differences in the price of futures on the exchanges.

## ROGUE TRADER

In 1992, BSS appointed Nick Leeson general manager of the new futures operation, granting him the authority to hire trading (front office) and settlements (back office) staff. Leeson had no experience in trading prior to his new appointment. His inexperience was deemed unimportant as the general manager's job did not involve direct trading. However, Leeson decided to take the necessary exams to qualify as a trader. Once Leeson passed his exams, he combined the roles of general manager and head trader. He was also *de facto* head of settlements as his inexperienced back office staff deferred to his greater back office experience. Assuming these three roles allowed Leeson to circumvent Barings' internal controls, as he could initiate a transaction and determine how it was recorded and settled.

In July 1992, Leeson used his control of front and back offices to open Error Account 88888. This was the account that he used to conceal trading losses and exaggerate his earnings, thus boosting his bonus. In his autobiography, Leeson claims that he used the account to hide embarrassing mistakes made by his inexperienced staff. However, Leeson was soon using the account to conceal his massive losses on unauthorized trading in Nikkei futures. At the end of 1992, the account showed a loss of £2 million increasing to £23 million at the end of 1993. Leeson's losses grew massively in 1994. Shortly before the Kobe, Japan, earthquake on January 17, 1994, Leeson sold put options (right to buy) and call options (right to sell) on the Nikkei simultaneously. The Nikkei fell slightly after the earthquake and Leeson panicked. He bought a vast amount of Nikkei futures in a vain attempt to stop the index from falling, further racking up the losses that broke Barings a year later.

The size of the losses was not discovered until Leeson fled Singapore on February 23, 1995. Three days later, Barings collapsed with debts of £827 million. On March 6, 1995 the Dutch financial services group Internationale Nederlanden Group (ING) acquired Barings Bank for the token sum of £1. Renamed ING Barings, the bank became the investment banking arm of ING.

SEE ALSO  
bank fraud; stock fraud; securities fraud; bond fraud; Leeson, Nick.

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## BASF

FOUNDED IN 1865, BASF (Badische Anilin- & Soda-Fabrik) of Ludwigshaffen, Germany, pioneered the industrial manufacture of dyestuffs. In 2003, BASF operated more than 100 large manufacturing sites and supplied chemicals and plastics to customers in more than 170 countries.

In 1925, BASF merged with Bayer, Hoechst and three other companies to form I.G. Farbenindustrie AG. Between 1933 and 1945, I.G. Farben played a central role in the Nazi economy. During World War II, the company manufactured poison gas used at extermination camps, and employed forced labor and slave labor. The strength of the links between I.G. Farben and the Nazi regime prompted the Allies to order the dissolution of the company in 1945, and several company directors and senior managers were tried for war crimes and crimes against humanity.

In 1952, a newly formed BASF inherited the Ludwigshaffen manufacturing site, marking the beginning of a new phase of plastics-driven growth. From the 1960s onward, the company internationalized its manufacturing and marketing operations, moving into North America and Asia, and sought to vertically integrate its operations, acquiring or developing businesses making consumer products or high value-added products. The creation of a horizontally and vertically integrated company has made BASF vulnerable to accusations of price-fixing, and the company has fallen afoul of antitrust authorities in several countries. However, these cases pale in comparison to the recent case of vitamin price-fixing.

At the end of the 1990s, U.S. antitrust investigators uncovered a series of cartels to fix the price of vitamins led by Hoffman-La Roche and BASF, then the world's two largest producers of vitamins. In May 1999, BASF and Hoffman-La Roche pleaded guilty to charges brought by the U.S. Department of Justice that they led and participated in a worldwide

conspiracy to raise and fix prices, and to allocate market shares for certain vitamins between January 1990 and February 1999. Hoffman-La Roche and BASF agreed to pay fines of \$500 million and \$225 million respectively. This prompted similar investigations by the antitrust authorities in Australia, Canada, and Europe.

The European Union investigation resulted in BASF, Hoffman-La Roche, and six other companies being fined record amounts for colluding to fix the price of vitamins. Hoffman-La Roche and BASF were fined approximately \$462 million and \$296 million respectively for participating in 12 separate cartels. According to the European Union Competition Commissioner Mario Monti, the case was "the most damaging series of cartels the commission has ever investigated."

### SEE ALSO

price fixing; antitrust; Justice, Department of.

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## Baycol

BAYCOL (or Lipobay and Cerivastatin) is a drug used to lower LDL (bad) cholesterol levels, thereby reducing the probability of a heart attack. Baycol belongs to a class of drugs known as statins that are designed to block the production of an enzyme that generates LDL.

It is very powerful and is therefore prescribed in low doses of 0.4 and 0.8 milligrams (mg). Baycol was released in the United States in 1997 by Bayer

AG, an enormous German conglomerate that manufactures chemicals and pharmaceuticals for global distribution.

By 1998, reports were being forwarded from physicians indicating adverse side effects from Baycol. In 1999, the Food and Drug Administration (FDA) approved the use of a potent dosage (0.4 mg) of Baycol. Several million people worldwide were taking Baycol and, in the process, were generating several hundred million dollars in profits for Bayer AG.

In 1999, Bayer AG responded to growing reports regarding the dangers of Baycol by issuing a warning on the drug's label and sent notices to doctors about the risks of prescribing Baycol in conjunction with a cholesterol drug called gemfibrozil, known on the market as Lopid.

In 2000, Bayer AG received approval from the FDA for a stronger, 0.8 mg version of Baycol even though the company had received a growing body of information stating that Baycol users were at a significantly higher risk of contracting rhabdomyolysis, a condition that dissolves muscle cells, releasing toxic chemicals into a patient's blood. Symptoms of rhabdomyolysis include, among others, dark urine, severe muscle pain, fever, dizziness, and vomiting—leading to an increased risk of kidney failure, paralysis, and (ironically) heart disease. By August 2001, the FDA announced that 31 Americans had died from taking Baycol with an unknown number of patients otherwise injured from the medication.

Also in August 2001, Bayer AG announced that it would remove Baycol from all global markets except Japan. Several hundred lawsuits against Bayer AG were settled, while several thousand additional lawsuits were ongoing. The company suffered a significant drop in its share values and has lost hundreds of millions of dollars in revenues and settlements, firing thousands of employees in an attempt to recoup these losses. Particularly noteworthy is the growing evidence that Bayer AG knew of the potentially lethal side effects of Baycol, but continued to market the drug. Its company report in 2001 stated that "The safety and health of our patients [has] priority over economic interests."

Roughly 100 deaths and 1,600 injuries have been reported in connection with Baycol use since 1997. Additional claims of injury continue. No criminal charges have been filed against Bayer AG as of early 2004.

#### SEE ALSO

pharmaceutical industry; consumer deaths; Food and Drug Administration.

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## Beech Aircraft

THE BEECH Aircraft Corporation was formed in 1932 by Walter Beech as a small aircraft manufacturer. In 1947, the company introduced the Beech 35 Bonanza, a single engine, four-passenger general aviation airplane that became an immediate popular success. This aircraft was widely considered the finest small plane on the market due to its combination of a luxurious interior and advanced design. Most importantly, unlike traditional aircraft which utilized a T-shaped "straight-tail" with a rudder on the vertical portion of the tail and elevators on the horizontal portions, the 35 Bonanza utilized a "V-tail" system combining the rudder and elevators on two tail surfaces that extended at 45-degree angles to the fuselage.

This revolutionary configuration lowered costs, gave the Bonanza a distinctive appearance, and reduced drag, which, along with its large engine and streamlined aerodynamic styling, allowed the Bonanza to achieve significantly higher air speeds than comparable aircraft. The combination of design, comfort and performance made the 35 Bonanza the Porsche of small aircraft.

In the 1950s, problems with the 35 Bonanza V-tail began to surface. First, pilots noticed that the plane had a tendency to "slosh around" during flight which could cause disorientation in inexperienced pilots, especially during instrument-only flying, and may have led to excessive wear in the tail section as the planes aged.

More seriously, the Civil Aeronautic Board reported numerous incidents of mid-air breakup of the Bonanza, several of which received widespread attention through subsequent lawsuits. The plain-

tiffs in *Prashker v. Beech Aircraft* (1957), in particular, claimed that the rate of in-flight failure rate of the V-tail was 15 times that of other aircraft.

In nearly all cases, the structural failures of the planes were associated with bad weather conditions, and the breakups were attributed to pilot error. The handling and performance characteristics of the plane made it possible for novice pilots to exceed the performance envelope of the aircraft during extreme conditions, leading to a fatal catastrophic failure of the airframe, particularly in the tail section. The conclusion of a Federal Aviation Administration (FAA) study in 1964, indeed, found a high incidence of in-flight breakup for the V-tail but took no further action.

Throughout the 1950s and 1960s, Beech made structural improvements to the 35 Bonanza to strengthen the wing and tail sections. In 1960, the company introduced the Beech 33 Debonair/Bonanza, essentially a straight-tail version of the Bonanza 35 and followed this up in 1968 with the Beech 36 Bonanza, a 6-passenger straight-tail model based on a stretched version of the original 35 airframe.

As the number of tail failures continued to mount during the 1970s, a 1978 FAA-commissioned study found that while the Bonanza had one of the best overall safety records in the industry, the 35 V-tail Bonanza was 24 times more likely to suffer from in-flight structural failure than the otherwise identical 33 and 36 straight-tail models. Faced with an increasing public perception that the V-tail was unsafe, Beech executives staged a publicity campaign in an attempt to revive sales.

Ultimately, this tactic was unsuccessful and production of the V-tail was halted in 1982 although the manufacture of the straight-tail models continued. In 1984, after 232 reported in-flight failures and over 500 fatalities between 1947 and 1984, Beech and the Department of Transportation conducted tests that revealed structural flaws in the design that could cause tail failure during specific maneuvers at high speeds. The company issued a speed advisory to owners until the development a tail-bracing kit. Following refitting, the in-flight breakup rate of the V-tails fell dramatically, quickly matching that of the straight-tail models.

That the V-tail Bonanza kept flying for over 35 years without an adequate fix and increasing evidence of a serious flaw can be attributed to several factors. First, tail failure generally occurred as a re-

sult of pilot error without the realization or acknowledgment that similar pilot errors in the straight-tail models did not lead to such catastrophic consequences.

Next, Beech was unwilling to take the simple step of replacing the V-tail with a straight-tail design at the first hint of a problem because the company realized that much of the allure of the 35 Bonanza was its unique appearance. Finally, by the time the evidence of a problem became plainly clear in the 1970s, any admission of a design fault would have subjected the company to significant legal liability in pending lawsuits.

#### SEE ALSO

consumer deaths; corporate criminal liability; defective products;

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## Beech-Nut Nutrition

ACCORDING TO JAMES S. BENSON, former Deputy Commissioner of the Food and Drug Administration (FDA), the FDA works hard to ensure that the "companies that produce the products under the agency's jurisdiction comply with the federal Food, Drug, and Cosmetic Act and other statutes enforced by the FDA." When the FDA began studying the possibility that manufacturers of fruit juice products were misleading consumers in 1982, Beech-Nut ranked as the second-largest baby food company.

The baby food industry was dominated by Gerber Products owning 70 percent of the jarred baby food market for 40 years; Beech-Nut and H.J. Heinz each had 14 percent of the market. *Financial World* reports that Beech-Nut began, in 1977, trying to gain a greater market share by selling a "cheaper adulterated product."

Steven Kindel reported, "Sales of that product brought Beech-Nut an estimated \$60 million be-

tween 1977 and 1982, while reducing material costs about \$250,000 annually."

When confronted by the FDA, Beech-Nut denied knowledge of any fraudulent conduct and refused to provide its records while sending FDA investigators on scavenger hunts to empty warehouses. When the company was finally forced to admit that its 100-percent apple juice was just sugar water, it claimed that the drink was still safe and should not be recalled; Beech-Nut agreed not to ship more bogus juice, but, in fact, continued to ship it. Beech-Nut stone-walled the FDA investigators long enough to sell an additional 700,000 cases of bogus juice and thus they were forced to destroy only 20,000 cases according to a report to the Nestlé Corporation which acquired Beech-Nut during the protracted cover up.

FDA investigators found that Beech-Nut had substituted colored water for apple juice over a period of years (1977–82). The 470-count indictment of the company and some of its officers charged them with conspiracy, mail fraud, and marketing flavored sugar water as apple juice with the intention of defrauding and misleading consumers. Beech-Nut pleaded guilty to 215 felony violations of the Food, Drug and Cosmetic Act and paid fines and costs of nearly \$2.2 million.

The Beech-Nut vice president for operations, John Lavery, was tried, convicted, and sentenced to one year and one day in jail. The president of Beech-Nut, Neils Hoyvald, was sentenced to six months of community service. Each man also paid a \$100,000 fine. In addition, the five companies that supplied the raw materials plea-bargained their way to lesser sentences.

Beech-Nut lost millions in "slumping sales because of the negative publicity generated by the case," Joseph A. Raelin explains, and goes on to assert that Beech-Nut (and Nestlé) could have escaped much of the scandal if they had listened to their own director of research and development, Jerome LiCari, who had produced evidence that their supplier was adulterating its juice concentrate. If the company had followed LiCari's advice, Beech-Nut would have been absolved of further liability. LiCari blew the whistle and resigned when his recommendations were ignored.

#### SEE ALSO

Food and Drug Administration; Food, Drug and Cosmetic Act.

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## Bendectin

FIRST MANUFACTURED by Merrell Dow Pharmaceuticals in 1956, Bendectin was a prescription drug used to alleviate nausea and morning sickness associated with pregnancy. Over 33 million pregnant women worldwide were taking the drug when Betty Mekdeci, a woman determined to find the cause of her son's severe birth defects, linked the defects to the Bendectin she took during pregnancy. The story broke in the *National Enquirer* in October 1979, implicating Bendectin as the cause of birth defects among thousands of newborns in the United States.

Women taking the drug panicked; some had unnecessary abortions, and thousands more sued Merrell Dow Pharmaceuticals. At one point, the company was faced with more than 1,800 lawsuits from women whose babies were born with defects. The cost of litigation exceeded the profit from the drug, and, in 1983, Merrell Dow stopped manufacturing Bendectin.

Merrell Dow's problem during litigation was a lack of scientific evidence. Specifically manufactured in 1956 for pregnant women, the three ingredients in Bendectin never underwent any reproductive toxicity tests. The only study to look at the teratogenic effects of the drug was performed by Merrell Dow researchers in the mid-1970s and it was of such poor quality that it did not hold up in court.

One of the Bendectin cases, *Daubert v. Merrell Dow*, actually lead the U.S. Supreme Court to set



guidelines for the admissibility of scientific expert testimony. Another problem was that Merrell Dow also neglected to mention the possibility of birth defects on Bendectin's pharmaceutical packaging label until 1981.

However, Bendectin is a safe drug; over 30 studies have proven that it does not cause birth defects. In fact, the Food and Drug Administration (FDA) continues to call the drug safe and the Centers for Disease Control reports no change in the incidence of birth defects in the United States after Bendectin was taken off the market. On the other hand, the number of pregnant women hospitalized for severe nausea has doubled since the drug was discontinued.

Duchesnay Inc., a pharmaceutical company in Canada, has continued to manufacture and distribute Diclectin, a drug identical to Bendectin. Duchesnay was petitioning the FDA in 2003 to sell the drug in the United States. Until approval, two of the three ingredients that make up Bendectin are available without a prescription, vitamin B-6 and doxylamine, an antihistamine found in Unisom. Many doctors have been instructing pregnant women suffering from nausea and its effects to find relief by combining specific amounts of these two ingredients.

#### SEE ALSO

pharmaceutical industry; Food and Drug Administration.

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## Bendix Corporation

IN AUGUST 1982, Chief Executive Officer Bill Agee, his wife and former strategy adviser Mary

Cunningham at his side, attempted to consolidate the Detroit-based manufacturer's position in the aerospace industry through a takeover of Martin Marietta. While Marietta undertook the largest ever "PacMan defense" (trying to buy Bendix first) the company's lead strategist, Martin Siegel of investment firm Kidder Peabody, illegally leaked the details to arbitrageur Ivan Boesky, who made a quick \$120,000 on Bendix stock. When the dust settled, Bendix was a subsidiary of a third firm, Allied Corporation; Martin Marietta had regained independence at the price of selling assets; and Boesky had cemented an insider-trading relationship with Siegel that would lead to Siegel's arrest in 1986.

Before resigning as vice president of strategic planning due to rumors that her rapid promotion had been earned in the bedroom rather than the boardroom, Cunningham had participated in developing a strategy for Bendix to become less dependent on the stumbling Detroit auto industry. Following this strategy, Bendix sold assets to build a cash reserve that would allow it to acquire technology-focused firms. After a failed pass at RCA, Bendix made an offer to buy 45 percent of Martin Marietta's common stock.

Wishing to avoid dismantling, Marietta countered with a two-tiered offer designed to stampede Bendix shareholders into tendering stock promptly. Marietta also persuaded defense contractor United Technologies to make a similar offer for Bendix stock. The scheme may have been aided by overlapping boards at United Technologies and Citibank, which had the power to tender the shares in the Bendix employee-held stock program.

A quirk in state incorporation laws made it possible for Bendix to gain control of Marietta but be unable to control Marietta's board, while Marietta could, days later, buy a controlling share in Bendix with immediate control of Bendix's board. If this happened, the companies would face debts worth triple their assets, plus years of legal wrangles. Bendix gained control of Marietta, but Marietta went ahead with its purchase of Bendix stock.

Agee engineered a deal to have Allied, an oil and gas company, buy both Bendix and Marietta. Allied then sold Marietta stock back to Marietta, making the company independent again. Financial journalist Alan Sloane estimates that the deal allowed the various players to take \$47 million in artificial tax losses. To cover debts incurred in the

merger battle, Marietta sold its cement and aluminum businesses. Rumors that United intended to buy Allied came to nothing.

Bendix was ultimately dismantled; after multiple mergers, its aerospace business went to Honeywell. The branded core business—manufacturing auto parts—was part of the Knorr-Bremse group in 2003. Agee was wafted into his own venture capital firm on a \$4.1 million golden parachute.

#### SEE ALSO

Boesky, Ivan; insider trading; board of directors; interlocking directorates.

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## Benson, Michael L. (1950–)

MICHAEL BENSON, A SOCIOLOGIST and professor of criminology, is the author of several books and articles on white-collar and corporate crime. He teaches criminological, white-collar crime, and life-course theories.

In 1998, Benson, along with co-author Francis T. Cullen, published *Combating Corporate Crime: Local Prosecutors at Work*. This book was the first major study of corporate crime prosecutions by local government. Benson and Cullen investigated how district attorneys, as publicly elected officials, actually responded to situations of corporate crime. Combining quantitative data and qualitative information, the book concluded that many prosecutors fail to hold corporate criminals accountable for behavior such as false advertising, unsafe working conditions, and environmental pollution.

The actions of prosecutors depended in large part on local economic, social, and crime conditions. The book by Benson and Cullen expounded on how factors such as population size, economic

conditions, and legal culture influence a community's attitude toward corporate crime. Community context, in turn, "strongly influences prosecutors' activity against corporate crime," the authors explain. The communities with strong and diverse economies were more likely to take the risk of controlling corporate crime.

Benson and Cullen offered recommendations for improving local responses to corporate crime. Their suggestions at the national level were to establish laboratories to help prosecutors investigate and prosecute environmental offenses; establish an information clearinghouse on prosecuting corporate crime; and establish personnel exchanges between federal and state regulatory agencies and between regulatory agencies and local prosecutors.

Their recommendations at the local level were to recruit prosecutors and investigators who have an interest in corporate-crime prosecutions; create a local-area computer network linking agencies that can share information; educate the public about their role and make it easier for citizens to report corporate crimes; increase the number of prosecutors and investigators assigned to corporate offenses; and assign investigators to environmental regulatory agencies so that they can identify cases that should be brought to the attention of prosecutors.

Benson's 2001 book, *Crime and the Life Course*, was a comprehensive overview of life-course theory as it applies to crime. The life-course perspective, in criminology, focuses on evidence of biological and genetic influences in criminal careers. Benson discussed an application of the life-course approach to white-collar crime. His research included a focus on the onset of offending behavior in white-collar criminals. He also described the connections between social locations, family backgrounds, educational trajectories, and conviction in white-collar offenders.

Benson's research and publications continue to augment the study of white-collar and corporate crime. Effective prosecution of corporate crimes will depend on the implementation of recommendations such as those offered by Benson and Cullen in their analysis of obstacles faced by prosecutors of corporate crime.

#### SEE ALSO

prosecution; Cullen, Francis T.; differential association; self control theory.

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## Better Business Bureaus

BETTER BUSINESS Bureaus, often referred to as BBBs, are free services developed to provide citizens with alerts to dubious advertising tactics or other similar problems associated with businesses. Better Business Bureaus are better referred to as a system of bureaus than as one bureau, as BBBs are established around the country and are charged with handling regional complaints and maintaining regional memberships.

Businesses may apply for membership with their regional BBB as a means of indicating to their customers that they subscribe to the most stringent of business standards and business ethics. The list of members is then available to interested parties via written requests or via the internet, with businesses being either rated as satisfactory or unsatisfactory.

A majority of the services offered by the BBBs are free to the general public, with the exception being the public mediation service offered by some BBBs.

All BBBs are interconnected through a national database. Therefore, if someone in Texas is having problems with a business in New York, then the BBB in Texas may be notified of the problem. The problem is then forwarded to the BBB in New York; this form of referral service is considered necessary because the business in question may be a member of the New York regional BBB and therefore be

more open to correction of the problem if influenced by the New York BBB.

The foundation for the Better Business Bureaus was formed in the early 1900s when the National Federation of Advertising Clubs of America was created with the intent of exposing individuals and companies that were presenting erroneous information about products and services. Prior to the establishment of this group, there was no regulation of companies and their advertising. Samuel Dobbs, who created the Ten Commandments of Advertising, was the organization's first president. Under Dobbs' leadership many regional advertising clubs began to emerge and sponsor local cities. In 1912, George Coleman, an advertising executive, formed a national group to monitor advertisement and business practices, and, in 1921, this organization was renamed the National Better Business Bureau. Today, there are numerous Better Business Bureaus in operation around the country.

Better Business Bureaus are often misunderstood by citizens who are under the impression that contacting the BBB is the first step in developing legal action against a business that has committed a wrong. BBBs do not normally get involved in criminal matters, and, in fact, few will even attempt to provide legal advice. Because BBBs are maintained on the basis of donations and small membership fees charged to businesses that are members of the regional bureaus, it is impossible to keep qualified attorneys on staff to answer complex legal questions. Should the BBB contacted determine that there is the potential for the development of a legal or criminal problem, then the group may recommend that the individual who was wronged contact the police or the district attorney. Additionally, BBBs do not normally get involved in disputes that arise between individuals and non-businesses; therefore, a dispute between two individuals would be declined for consideration by the BBB.

Advertising trends and claims are monitored by BBBs, with over 100 regional BBBs responsible for monitoring their areas. The information obtained from both this monitoring, and claims that are found to be with merit, are maintained in an internet database. A concerned citizen merely has to go online and locate her regional BBB or the National Better Business Bureau and search for information by company name, state, or city. Individuals who do not have access to the internet may still contact the BBB through the use of an automated telephone

system. Through consolidation of the information obtained in the course of operation, BBBs will routinely provide training or education for consumers concerning how to avoid becoming victims of fraud and improper business actions. With the increase of identity theft and credit-card fraud in recent years, many BBBs have begun offering training on how to spot potential identity thieves and how to prevent them from gaining access to personal financial information.

Through the national BBB website, individuals who have been victims of identity theft may access information related to repairing the damage caused by the criminal act. Another recent development by the BBB is the sanctioning of automotive car dealerships as a means of ensuring customer care and respect.

The future of the BBB is unknown but it is possible that the BBBs will become more involved in education relating to online shopping and electronic businesses as more specialized divisions continue to be developed.

#### SEE ALSO

advertising fraud; scams; bait-and-switch; contractor fraud.

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## B. F. Goodrich

IN 1870, Dr. Benjamin Franklin Goodrich established the B. F. Goodrich Company. It was the first rubber company west of the Allegheny Mountains, and set up headquarters in Akron, Ohio. However, it was in the year of 1969 that B.F. Goodrich received national attention, not for its products and revolutionary inventions, but for a scandal.

On June 18, 1967, the B. F. Goodrich Wheel and Brake Plant in Troy, Ohio, received a contract to supply wheels and brakes for a new air force aircraft. Goodrich proposed a lighter-weight, four-

rotor brake instead of the traditional five-disc brake. Before the air force could accept the brake, B. F. Goodrich had to present a report showing that the brake passed specified military qualifying tests. The last two weeks of June 1968 were set aside for testing the brake, giving Goodrich almost a full year for design and testing.

John Warren designed the brake, but Searle Lawson, a newcomer to B. F. Goodrich, was assigned responsibility for final production. Lawson began testing the brake using a prototype. In the first round of testing, the prototype reached 1,500 degrees. After a few tests, the linings of the brakes were almost totally disintegrated. Lawson tried new linings, thinking that was the problem, not the brake, but the same thing happened. He came to the conclusion that there was a design flaw, the four-disc brake was too small and a five-disc brake may be more effective. At this point, a redesign of the brake would mean delay and this meant that the brake would most likely not be ready for delivery on time. Goodrich had assured the air force that the four-disc brake was possible and would be ready. Warren, the original designer, did not want to admit to any error or like the idea that a new employee, fresh out of college, had found the error. Warren believed it was the linings that were the issue, not the brake design. According to Warren, the four-disc brake was viable, and that was that.

The disagreement between Lawson and Warren meant that upper management needed to be consulted. Lawson approached the project manager, Robert Sink to explain the problem. Sink, knowing the politics of the company, was not willing to disagree with Warren. He believed that Warren would be able to fix, or at least minimize, the problem, since he had designed the brake. Sink advised Lawson to continue testing the linings using various other materials. A total of 12 tests were conducted, each resulting in failure. It was becoming evident that the brake was faulty not the linings. Test flights by the air force were now only 70 days away. Only a major redesign could fix the problem. Panic set in. During the testing phase by Lawson, Sink had been continually assuring the air force that the brake tests were going smoothly, which was a complete fabrication.

In April 1968, Kermit Vandivier became involved with the brake. He had discovered many discrepancies between the military specifications and the qualification tests carried out at Goodrich. It

was Vandivier's job to write the appropriate documentation that would accompany the testing data in the qualification report. Given the discrepancies, Vandivier questioned whether he should write a report that was so out of line with the military specifications. Vandivier took his concerns to his immediate supervisor. He was assured that the testing laboratory would not issue a misrepresentation of the qualification tests. However, within a few days, a typewritten copy of the test logs was sent out. Virtually every entry in the test logs was significantly altered. On hearing of the interim report, Vandivier questioned Richard Gloor, test laboratory engineer, who told him that Lawson had directed the test lab to miscalibrate the instruments, at the order of one of Lawson's superiors. When Vandivier approached Lawson about the changed report, Lawson confirmed Gloor's account. Lawson told Vandivier that he had been told that no matter how the brake continued to test, Goodrich was going to qualify it.

The brake was nursed through the last test and Vandivier was told to write up the final report that it passed and was qualified according to specifications. Vandivier was incensed and refused to write a qualification report he felt was based on falsified data. He had no choice though. Goodrich submitted the qualification report on June 12, 1968, without either Vandivier or Lawson notifying the chief engineer or Goodrich corporate headquarters in Akron of their misgivings.

In mid-June 1968, flight tests on the brake began at Edwards Air Force Base in California. Lawson witnessed the tests on Goodrich's behalf. There were numerous mishaps during the flight tests. Both Lawson and Vandivier were concerned over the safety of the brake and the fact that the reports were falsified. They both decided, from advice from their attorneys, to go to the Federal Bureau of Investigation (FBI). At the same time, because of the various mishaps during testing, the air force was demanding the raw data from the qualification tests conducted by Goodrich. Goodrich declined the request.

Lawson resigned from Goodrich and Vandivier was dismissed from Goodrich for disloyalty. He soon took a job at the *Troy Daily News* and told his editor about the problems he had at Goodrich. The story reached Senator William Proxmire who was receptive to Vandivier's tale of misdeeds at Goodrich. On May 13, 1969, Proxmire requested that the Government Accounting Office (GAO) re-

view the brake qualification testing performed by the Goodrich plant in Troy. The GAO reviewed the operations at Goodrich and submitted a report to Proxmire on July 3, 1969. Once the report was received, Proxmire made a public announcement on the Senate floor about Vandivier's allegations against Goodrich and the GAO investigation.

In August 1969, a Congressional Hearing, chaired by Proxmire, was held before the Subcommittee on Economy in Government. The GAO Report and Congressional Hearing testimony illustrated that Goodrich's qualification testing procedures did not comply with government specifications.

The Goodrich brake scandal is an example of how a corporation may duck responsibility for the sake of making a profit, and how employees may blow the whistle on such fraud. The brake could have caused major malfunctions in the aircraft and pilots could have died, but luckily, the defective brake was never used. Goodrich eventually went back to the five-disc design.

#### SEE ALSO

whistleblowers; government contract fraud; corporate criminal liability.

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## bid rigging

**BID RIGGING CONSTITUTES** a violation antitrust law. It is closely related to horizontal price-

fixing, in that both offenses involve collusion between supposed competitors in the same market group. Horizontal price fixing is a conspiracy between businesses at the same market level to set a fixed price for their product. That price is often set well above of what the price would be if it were set in a truly competitive market.

For example, two large beverage companies have been charged several times over the years with fixing the price of soft drink syrups, as well as the price of the final soft drink product. Were the companies to have competed honestly in the market, it is likely that the price of those products would have been much lower than they were. Horizontal price-fixing is a very common offense, in part because it is very difficult to prove that a conspiracy to fix the price of a product actually has occurred.

Bid-rigging comes about in situations in which companies are required to competitively bid on contracts. Competitively bid contracts are very common in the marketplace, particularly in government and education, where agencies are generally required to accept the lowest bid for a contract. For example, schools advertise for annual contracts for milk and bread. It is not unusual for competitors in the same market place to conspire to allow one or the other to win a competitive bid in rotation.

The end result is that each of the companies will make a profit, often at a price well above that which they would have earned in a truly competitive market. The added costs resulting from the rigged bid are passed on to taxpayers, ratepayers, and consumers. An example of a major bid-rigging case was described by Gilbert Geis in his classic article (1967) about the heavy electric equipment cases of 1961. In those cases, all of the major producers of electricity-generating equipment conspired to rig the competitive bids for equipment to be sold to the Tennessee Valley Authority (TVA) during the 1940s to 1960. Managers of the companies, such as Westinghouse and General Electric, would periodically meet to determine which company would submit the winning bid, and what price each company would bid.

The conspiracy cost TVA millions of dollars in excess of what it would have had to pay if there had not been collusion in the market place. The conspiracy collapsed when TVA received two identical bids for the same contract. TVA contacted the Antitrust Division of the U.S. Department of Justice, which developed criminal and civil cases against the com-

panies and their managers. The companies pled guilty, as did a number of the managers. A few of the managers served brief jail terms, and the companies paid fines. As Geis pointed out, though, for General Electric the fines were equivalent to a person having to pay a \$2 parking fine. Bid rigging, like price fixing, is hard to prove. Often, the only way that bid rigging is detected is when a bidding error is made, as in the TVA case.

#### SEE ALSO

price fixing; antitrust; Clayton Antitrust Act; Federal Trade Commission; General Electric.

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## board of directors

INVESTORS DEPEND on the board of directors to govern a firm, to set its strategic quality and direction, and to improve their shareholder value. Banks and stock exchanges around the world have started to assess the effectiveness of boards of directors regarding their role and composition, and have a main focus on developing good corporate governance practices. The trust that investors have placed in boards of directors has, in the late 1990s and early 2000s, been damaged by several abuses and business scandals.

Research into boards of directors reveals they are dominated by a tradition in which board composition is related to firm performance, and this has galvanized the efforts of large-scale investor groups to initiate boardroom changes.

Researchers Shaker A. Zahra and John A. Pearce (1989) highlighted the main differences between board attributes (composition, characteristics, structure, and process) and board roles (service, strategy and control). On the other hand, scholar Andrew A. Pettigrew (1992) synthesized and re-

viewed elements of the research on managerial elites. This survey discussed research from three different conceptual traditions (interlocking directorates and the study of institutional and societal power, boards of directors, and top management teams).

The author found that studies of boards of directors remain at an early stage. Before links can be made between independent (most often, board composition) and dependent (most often, various measures of firm performance) variables in research about boards, there is a need to go deeper into the substance. Also, other scholars found that the research provides little consensus as to the specific configuration of effective boards. Findings are inconsistent and links are modest. More insight needs to be gained into the purpose and meaning of company organization and direction with a board of directors at the helm.

## PERFORMANCE AND ROLE

Board task performance and board roles have been categorized in various ways. Categories are based on legislation, theories, stakeholder expectations, and induction. The most common distinction is between the board's control roles and service roles. The strategy roles and resource dependency roles are in many studies or reviews also treated as general categories, but more specific board roles such as networking, lobbying, advising, influencing, ratifying, being a sounding board, etc. are also used in some studies. Some studies also present the board's roles in various business functions such as finance, operations, human resources, markets, and product development.

The composition of board members has traditionally been the measure used when studying boards. The most common board-member variables have been board size, chief executive officer (CEO) duality, and various measures of insider/outsider ratios. There has also been an interest in the number of women directors. In studies, there has also been an interest in outside directors, family members, founders, and venture capitalists. In addition, board members should be studied both from a supply side (board members seeking assignments) and a demand side (companies seeking board members).

What motivates individuals to sit on a board, and what motivates them to focus energy, effort, and time to working on a board? How are board

members selected? What are the attributes of board members that are needed beyond affiliation, gender, and independence? What are the roles of industry experience, age, and tenure? What characterizes women directors versus male directors? What is the role of homogeneity versus diversity with a decision-making body? What aspects of homogeneity and diversity exist and are important to decision makers? What are the dynamics when directors' interlock (sit on different boards of intertwined companies)? We still know little about how much time it takes to be a board member or the outcome of attendance to the decision-making process of board members.

Board working structures include: frequency of meetings, location of meetings, time of meetings, the setting and distribution of the board agenda, form, content, distribution and follow-up of board minutes or protocols; and the organization and leadership of the board. How formal are the board meetings, and what is the order of the board agenda? How formalized are the rules of the boardroom and how often are board members absent from board meetings? How does voting take place and how often are disagreements written down in the protocols?

The importance of processes inside and outside the boardroom has been highly emphasized by many authors, but the traditions for studying and observing board processes are limited. Concepts related to board processes are: "Rules of the game," reciprocity, trust, and integrity; and emotions, power, coalitions or alliances, and ruling techniques. The questions of board independence, effort norms, cognitive conflict, and the use of knowledge/skills are also greatly related to board processes.

The relationship that has received the most attention is between board members and firm performance. A series of papers clearly shows that it is difficult to find any reliable patterns in the large number of studies of these relationships. Research should thus probably be re-addressed toward studying the effects of board size, board composition, and CEO duality on firm performance.

What influences board members? One immediate alternative would be to use the mentioned board variables as dependent rather than independent variables. Environmental contingencies may influence the selection and composition of board members. This influence may be direct as well as indirect.

Some scholars argue that boards are empowered by various kinds of trust relationships between internal and external stakeholders. Some of the relationships between attributes of the board members and board task performance may be direct, but there may also be mediated effects, and some effects may be moderated. The board's working approach will have such effects, according to researchers Ada Demb and Friedrich Neubauer (1992). The working approach includes board structures and processes.

What is the relationship between board task performance and firm performance? A fair answer may evolve from another source outside the confines of current literature. At the most practical level, the prevailing knowledge highlights serious problems in literature reviewing corporate governance based entirely from a research perspective of a board of directors.

In short, the importance of boards of directors in corporate governance has been widely reviewed in scientific literature. However, the diversity of measures and concepts involved in the various streams of research make it difficult to interpret and come to a conclusion about the nature of the influences emerging from the power base of a board of directors.

Over the last few years, almost all European countries adopted corporate governance codes of conduct to increase transparency, and reduce managerial opportunism. European nations are attempting to ensure corporations are taking into account all the interested parties and not just the select few interested in self-preservation.

#### SEE ALSO

interlocking directorates; outside directors; elite crime.

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## Boesky, Ivan (1937–)

IVAN BOESKY IS a first generation American. His father, William, immigrated to the United States from Russia in 1912. The elder Boesky owned several nightclubs in the Detroit, Michigan, area. Striping and topless dancing were introduced to increase their profitability. This drive for maximum profits and dedication to hard work would be a driving force for Ivan throughout his life.

Boesky, with the work ethic instilled in him by his father, sold ice cream from the back of a truck. He was repeatedly arrested for breaking the conditions of his license, which stated his curfew was 7:00 P.M. Ivan attend Cranbrook, a college preparatory school in the suburbs of Detroit. Academically, he was average. He did, however, distinguish himself as a superior wrestler, winning his school's award as the most outstanding wrestler. After his sophomore year, he transferred to Munford High in Detroit's inner-city.

Boesky, attended several institutions of higher education, Wayne State, Eastern Michigan College and University of Michigan, but he never graduated. After spending a few years in Iran, where he admitted he worked for the CIA, Boesky enrolled in the Detroit College of Law. The less than prestigious law school did not require a degree for admittance. Upon his graduation in 1964, he was rejected by every law firm in the Detroit area to which he applied.

Boesky met his future wife, Seema Silberstein, in 1960. Her father was a successful real estate developer in the Detroit area. They were married and Boesky's first job was serving as a clerk for a federal district court judge who was a relative of Seema. Soon after, a former Cranbrook prep school classmate introduced Boesky to the term *merger arbitrage*.

In its basic form, merger arbitrage deals with investing in potential take-over targets, and then realizing the profits when the merger is completed. This seemed to intrigue Boesky and he soon had his



sights set on the world of high risk and high reward that could only be found in New York City.

Ben Silberstein, Boesky's father-in-law, set-up Boesky and his wife in a luxurious apartment on New York's Park Avenue. He quickly secured employment in a trainee position at L.F. Rothschild. After a year he headed to First Manhattan where he got his first experience in arbitrage. Soon after, he took a position at Kalb Voohis. After he lost \$20,000 in a position, he was subsequently dismissed.

Boesky was not deterred by his dismissal. He soon landed a position with Edwards & Hanly. He quickly used maximum leverage and \$1 million positions and actually influenced individual stock prices. Boesky trading tactics caught the eye of the Securities and Exchange Commission (SEC). He received a \$10,000 fine from the SEC for shorting stock improperly. In 1975, these questionable and aggressive actions bankrupted Edwards & Hanly.

#### IVAN F. BOESKY CO.

In 1975, Boesky was ready to go into business for himself. He founded Ivan F. Boesky Co. and needed investors. He advertised in *The Wall Street Journal* touting the profit potential that the world of arbitrage offered. Boesky organized the company so investors incurred 95 percent of the losses and shared 55 percent of the potential profits. Boesky's firm was responsible for the other 5 percent of the losses, and Boesky would pocket 45 percent of the profits for himself. While Boesky did attract several investors, he had to rely on Seema's family to furnish the rest of the capital needed for the company to get off the ground.

Boesky was a workaholic. In a 1984 article in *The Atlantic Monthly*, Connie Bruck describes a typical day the life of Boesky. She described him arriving home at 1:00 A.M., then doing homework until approximately 2:30 A.M. He then went to bed and usually woke before his alarm sounded. Boesky continued to do paperwork while being driven into Manhattan for a 6:00 A.M. meeting. He went from one meeting to the next, but was always behind his desk when the market opened at 10:00 A.M.

Boesky was involved in numerous highly profitable investments and arbitrage cases in his career. In 1981, after an employee commented that a new movie, *ET*, would be one of the largest box office movies of all time, Boesky bought 250,000 shares of

the movie's producer, MCA, at a cost of \$10 million. In the next two days he made \$500,000 in profit. Boesky's attention to detail and research paid off in several large arbitrage cases. Boesky held large positions in Texaco's takeover bid for Getty Oil, and Standard Oil Company of California's bid for Gulf Oil. These two deals grossed Boesky an estimated \$115 million.

In the mid-1980s, Boesky authored *Merger Mania: Arbitrage: Wall Street's Best Kept Money-making Secret*. In this book, he describes how speculators can gross large profits by investing in companies that are takeover targets. Boesky also spoke as the commencement speaker at the University of California's graduation ceremonies in 1986 where he stated "Greed is all right" and "I think greed is healthy." These remarks generated a large round of applause.

Boesky's fall from grace began in 1985 when the SEC charged David Levine with insider trading. The SEC learned that Boesky had received a percentage of the profits from Levine for insider information. In an agreement with the SEC, Boesky began to record conversations with other arbitrageurs and junk bond dealers. These recorded conversations led to the indictments and convictions of several prominent people in the world of high finance. Michael Milken of Drexel, Burnham, Lambert, was a high-profile conviction. He was sentenced to 10 years in prison and ordered to pay into a \$1.3 billion fund to settle several hundred lawsuits.

Boesky's cooperation with SEC allowed him to divest most of his assets. This saved him millions of dollars in liability. Boesky was sentenced to five years in prison. Although he escaped a fine, he did agree to pay the SEC \$100 million for insider trading irregularities he was associated with. In 1990, Boesky was paroled and sent to a halfway house in Brooklyn, New York. While there, he served as a consultant earning a meager \$200 a week. This was far from the earnings he had made as a feared tycoon on Wall Street.

#### SEE ALSO

insider trading; securities fraud; Milken, Michael; Drexel, Burnham, Lambert.

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## Boland Amendment

SHORTLY AFTER taking office on January 20, 1981, Republican President Ronald Reagan decided that he would do everything possible to overthrow the Sandinista pro-communist regime in Nicaragua. Reagan regularly sent requests to Congress seeking appropriations to support the rebel anti-communist Contras, and Congress complied for two years.

However, after it became known that the Central Intelligence Agency (CIA) had been mining the harbors in Nicaragua, Congress realized that if CIA explosives destroyed Soviet ships anchored nearby, an international incident of gigantic proportions could occur. Congress subsequently withdrew its support for funding the Contras. Undaunted, Reagan continued his quest to overthrow the leftist Sandinista regime. The activities of his administration created a major scandal and threatened his presidency.

In response to the president's activities in Nicaragua, on December 1, 1983, Congress passed the first Boland Amendment, attaching it to an omnibus appropriation bill for fiscal year 1983. The Boland Amendment, named after its chief sponsor Edward P. Boland (D-MA), prohibited the CIA, the Department of Defense, and other government agencies or entities that were involved in intelligence from using any funds whatsoever "for the purpose of overthrowing the government of Nicaragua or providing a military exchange between Nicaragua and Honduras." The Boland Amendment passed both house of Congress. Without a line-item veto, Reagan had no choice but to accept the amendment or veto the entire appropriations bill.

He signed the Boland Amendment into law on December 21. Because Congress attached the Boland Amendment to defense appropriations, the restriction was effective only from December 1984 to December 1985.

Even before the Boland Amendment took effect, Reagan had already told National Security Ad-

viser Robert "Bud" McFarlane, to keep the Contras together "body and soul." The fact that the first Boland Amendment contained two significant loopholes made McFarlane's task easier. First, Congress had given the CIA permission to offer aid to the Contras as long as its stated purpose was something other than overthrowing the Sandinistas. Second, the Reagan administration had determined that it could use the National Security Council (NSC) rather than the CIA to conduct covert activities in Nicaragua and still obey the letter of the law. Four months later, the president was still assuring Congress that he was not trying to overthrow the Nicaraguan government at the same time that his administration was busily seeking ways to fund the covert activities. As 1985 drew to a close, Congress was determined to end all funding to the Contras and informed the president that the \$24 million appropriation for humanitarian aid for 1985 would be the last appropriation.

On December 8, 1985, Congress passed the second Boland Amendment aimed at closing the loopholes of Boland one. It was structured to pick up when Boland one expired and to remain in effect until December 30, 1986. In the new amendment, Congress prohibited any government agency from offering military and paramilitary support for the Contras and banned the Reagan administration's practice of soliciting funds from third-party countries and private donors. During debate on Boland two, Representative Boland was asked if there were any exceptions to the ban, and he stated that there were none. Even humanitarian aid to the Contras was banned. Representative Dick Cheney (R-WY) called Boland two a "killer amendment," specifically intended to make the Contras give up their fight.

After the Iran-Contra scandal broke (which revealed covert funding for the Contras), Congress investigated the Reagan administration's defiance of the Boland Amendment and learned that between 1984 and 1986, Reagan and the NSC staff had raised \$34 million for aid to the Contras from third countries such as Saudi Arabia. Millions more were raised from donors at conservative fundraisers.

Initially, these funds were deposited in a Swiss bank account controlled by the Contras, but in July 1985, Lieutenant Colonel Oliver North, a member of the NSC staff, took control of the money. For 19 months after Congress banned funding to the Nicaraguan Contras, the Reagan administration

continued to conduct a covert war in the Central American country.

In July 1989 Senator Daniel Patrick Moynihan (D-NY) introduced a bill designed to permanently keep a president from subverting the wishes of Congress by making it a felony to do so. Reagan's vice president and successor, President George H.W. Bush, promised to veto the bill if it passed, arguing that it was an intrusion into a president's constitutional right to conduct foreign policy. The bill passed both houses of Congress, and Bush vetoed it as promised.

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Iran-Contra; North, Oliver; Reagan, Ronald; Bush, George H. W.

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## bond fraud

**BOND FRAUD** involves the sale of stolen, fraudulent, or worthless United States securities. The Securities Act of 1933 defines a security as "any note, stock, treasury stock, security future, bond, collateral-trust certificate, or certificate of deposit." The most common bond used to perpetrate fraud is the historical bond.

Historical bonds, which were once valid securities of various American entities, are now worthless as securities and only collected and traded as historical memorabilia. Swindlers are selling historical bonds to naive investors at prices far exceeding their fair value as collectibles, claiming that the bond is worth millions of dollars, is redeemable in gold, and is backed by the U.S. Department of the Treasury.

Swindlers typically supply third-party valuations or authentications supporting their claims.

These bonds, however, have no value as investment securities, are not redeemable in gold, and were never backed by the Department of the Treasury.

### RAILROAD BONDS

The most popular historical bond peddled by swindlers is the railroad bond. According to the Department of the Treasury, there are 12,000 to 15,000 different varieties of railroad bonds in existence. The most common railroad bond in circulation is the Chicago, Saginaw, and Canada Railroad Company. In 1873, the Chicago, Saginaw, and Canada Railroad Company issued 5,500 30-year gold-backed bearer bonds, which paid 7 percent interest to finance construction of the proposed railroad. In 1876, the Chicago, Saginaw, and Canada Railroad Company was forced into bankruptcy and its assets were acquired by CSX Transportation Incorporated. CSX Transportation did not assume any of the Chicago, Saginaw, and Canada Railroad Company's outstanding debt, including the railroad bonds. All claims to money due under the bonds, which had a face value of \$1,000 apiece, was settled during Chicago, Saginaw, and Canada Railroad Company's bankruptcy preceding.

At that time, investors presented their bonds for payment and received less than 25 cents on the dollar. Following the bankruptcy preceding, the bonds were stored in the court archives until they were discovered in the basement of a federal building. At that time they were purchased by a museum in Michigan, packaged with other historical information about the Chicago, Saginaw, and Canada Railroad Company, and sold as collector's items for \$29.95 each.

The U.S. District Court for the District of Wyoming held that the Chicago, Saginaw, and Canada Railroad Company bonds possess only nominal value as collectibles. On January 20, 1998, the Securities and Exchange Commission (SEC) filed a motion for preliminary injunction against Daniel Schneider and three codefendants. The SEC alleged that Schneider, doing business under the name of Global American Prosperity Foundation, perpetrated securities fraud in violation of the Securities Act of 1933 and the Securities and Exchange Act of 1934.

The Securities Act of 1933, often referred to as the truth in securities law, requires that "investors receive financial and other significant information

concerning securities being offered for public sale and prohibits deceit, misrepresentations, and other frauds in the sale of securities.” The Securities and Exchange Act of 1934 prohibits certain types of conduct in the securities market and empowers the Security and Exchange Commission with disciplinary powers over regulated entities and persons associated with them.”

During trial, Schneider testified that he had sold Chicago, Saginaw, and Canada Railroad Company bonds to various individuals for approximately \$40,000 per a bond. Witnesses testifying on behalf of the Securities and Exchange Commission stated that the bonds were accruing 7 percent interest since their issuance in 1872. Therefore, the bonds could be cashed at a bank for a price of \$2 million to \$5 million per bond. Schneider also claimed that there was minimal risk associated with the purchase of the bonds because they were secured by gold bullion and coins. According to the court, the plaintiff “convincingly demonstrated the existence of an elaborate shell game designed to defraud easily duped investors.” On August 31, 1999, Schneider was found guilty of violating the Securities Act of 1933 and the Securities and Exchange Act of 1934.

### TREASURY BONDS

There are a number of fraudulent schemes involving United States Treasury bonds originating in the Far East and in particular the Philippines. According to the Department of the Treasury, one type of fraudulent bond being produced in the Philippines is the Federal Bond. The United States purportedly shipped these bonds to the Philippine Freedom Fighters during World War II to assist with the war effort. In actuality, these fraudulent bonds have been produced by scanning the images of George Washington from the \$1 bill, Ben Franklin from the \$100 bill, and Grover Cleveland from the \$1,000 bill into a computer graphics program. The amounts are then altered to read \$100 million and \$500 million and coupons are attached in both the English and Chinese language. The fraudulent bond is then printed using modern color copiers or printers. The Department of the Treasury did not issue bonds in \$100 million or \$500 million denominations during this time period. In February 2001, the U.S. Secret Service seized more than \$2 trillion worth of these fraudulent bonds in the Philippines.

A second fraudulent bond being produced in the Far East is the Chiang Kai-shek Bond, which has a face of \$100 million. According to the Treasury, it has been alleged that these bonds were issued by the Central Intelligence Agency between 1930 and 1940 to help fund the Chinese Nationalist regime of Chiang Kai-shek in his war against the Chinese communists. The bonds supposedly were buried in caves by Chiang’s generals and heirs for years before recently being discovered. They are now being fraudulently offered to people at a fraction of their face value. According to the United States Department of the Treasury “this story is false and these securities do not bear provisions that even remotely resemble Treasury securities.”

### JUNK BONDS

Fraudulent schemes involving U.S. securities have occurred on a much larger scale, having a tremendous impact on Wall Street. Beginning in 1970, at a time when the bond market had stagnated and bonds were at their lowest points since the Great Depression, a new breed of investment banker was emerging. One would eventually become the symbol of greed that would corrupt Wall Street and his name was Michael Milken. Milken attended the University of Pennsylvania’s Wharton School of Business and worked part-time for two years with the firm Drexel Harriman Ripley.

Prior to completing his studies at Wharton, Milken was offered a position in what was now Drexel Firestone’s research department on Wall Street. Milken soon moved to the company’s bond trading department. Since his undergraduate days, Milken had been fascinated with a very small area of the bond market, high yield, low-grade bonds, or what would eventually be called junk bonds. A majority of the bonds trading on Wall Street at the time Milken arrived, however, were investment-grade and rated AAA. They were virtually risk-free, however, they barely earned a bit more in interest than a U.S. Treasury bond. Milken’s specialty was deep-discount bonds, which were rated BB or lower.

At this time there was little demand on the market for junk bonds and trading was extremely limited. Investors were reluctant to place their money in unrated debt. Moreover, these bonds were issued by obscure companies whose credit strength was extremely weak and at times questionable. Milken, however, was able to find a place for junk bonds and

beginning with \$2 million in capital, he was able to generate a 100 percent rate of return.

When an economic recession hit in 1980, investment bankers began bailing out of the junk bond market. Milken, however, continued to increase Drexel's control over the market. He devised ways in which to creatively restructure debt. While some underwriters were suffering default rates as high as 17 percent, Drexel's defaults never exceeded 2 percent. By 1983, the junk bond market was larger than ever and, as one commentator put it, "Drexel was entrenched firmly at the top and Michael Milken was hailed as the king." Milken continued to expand his empire and in 1985, he partnered with Ivan Boesky and devised a strategy for establishing the largest arbitrage organization in history. Boesky dissolved his corporation and raised \$220 million from a new group of limited partners, and Milken raised \$660 million with junk bonds. Boesky had no difficulty attracting partners to put up \$220 million, while Milken struggled to sell investors on a \$660-million arbitrage fund. Eventually, however, the money was raised.

In the spring of 1986, the Los Angeles based home building products company, Wickes Corporation, was emerging from bankruptcy. The chairman of Wickes, eager to acquire another corporation, turned to Milken. Milken was able to raise hundreds of millions of dollars by issuing junk bonds and preferred stock, which paid a 10 percent dividend in order to attract investors.

There was, however, an unusual provision included in the preferred offering that read, "If the Wickes stock rose to a specific level, the company could redeem its preferred stock and replace it with common stock." Meanwhile, Milken had Boesky manipulate the Wickes stock by purchasing 2.8 million shares over a very short time period. This inflated the price, which allowed Wickes to eliminate the preferred stock and in the process save approximately \$15 million per year.

## BOESKY & MILKEN

The following year, Boesky arranged a meeting with Milken at a Beverly Hills, California, hotel. When the two met, Boesky wanted to talk about a \$3.5 million kickback he owed Milken from the arbitrage deal. Milken simply responded by telling Boesky to keep it. Boesky steered the conversation to the two's business dealings, while Milken chose

to speak of electronic surveillance. Unknown to Boesky, Milken had been made aware of the fact that Boesky had agreed to cooperate with the Securities and Exchange Commission in exchange for leniency in sentencing for insider trading. Just two weeks later, Boesky's ongoing cooperation was announced and by mid-1988 he was in prison serving a three-year sentence. The investigation into Milken had come to a standstill. In September, however, Milken's top salesman agreed to cooperate with the government in exchange for immunity from prosecution.

The government immediately filed federal racketeering charges against Milken. Drexel, Milken's employer, entered into a plea bargain in which it agreed to acknowledge wrongdoing, pay a \$650 million fine, and suspend Milken. In March 1999, Milken was indicted by a federal grand jury on 98 felony counts and racketeering charges. Six months later, the junk bond market collapsed and Milken pled guilty to six felonies and paid a fine of \$600 million. On November 21, 1990, Milken was sentenced to 10 years in prison, which was later reduced on appeal to two years. Milken's control and manipulation of the junk bond market had come to an end.

## SALOMON BROTHERS

One year later in 1991, the major Wall Street investment firm, Salomon Brothers, successfully took control of the U.S. Treasury Bond market. Salomon was one of a select group of buyers allowed to bid on government securities in the primary market. The primary market is a market for new issues of securities. The securities purchased in the primary market are then resold in the secondary market to the general public.

In order to ensure competition in the primary market, federal regulations prohibit individuals or firms from purchasing more than 35 percent of any bond issue. On three separate occasions, however, Salomon traders far exceeded that limit by submitting fraudulent bids using the names of their clients. Consequently, Salomon effectively cornered the Treasury bond market, and, in the process, illegally inflated its profits. Shortly thereafter, the head of the bond-trading desk at Salomon Brothers was accused of manipulating the bidding at government auctions of Treasury securities, which had resulted in millions of dollars in illegal profits.

## SEE ALSO

stock fraud; securities fraud; Securities and Exchange Commission; Milken, Michael; Boesky, Ivan; reform and regulation.

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## boycott

THE FEDERAL Trade Commission (FTC) ruled in 1998 that toy retailer Toys "R" Us had, in the late 1980s and 1990s, engaged in an illegal boycott of warehouse clubs by indicating that it would not do business with toy makers who also did business with the clubs, thereby coercing manufacturers to institute a boycott of the warehouse clubs. Toys "R" Us was the major toy retailer, controlling more than 40 percent of the market. Both the threat to withhold business from the manufacturers and the attempt to force other toy suppliers to boycott the warehouse clubs were illegal boycotts under antitrust law.

The term *boycott* is named for Captain Charles Cunningham Boycott, whose ruthless evictions of tenants in Ireland in 1880 provoked his employees so much that they refused to have any dealings with him or his family. In the United States, the principal historical use of the boycott has been in labor dis-

putes, but consumer and business groups have used it as well.

Not all boycotts are illegal. Generally, a primary boycott is legal. The primary boycott is, as in the example of Boycott's employees, a refusal to have dealings with the offender. For instance, protesting employees and their sympathizers might refuse to use an employer's goods or services, as in the 1960s boycott of table grapes by the United Farm Workers Organizing Committee and sympathetic consumers. The primary boycott is legal and accepted practice because, although it attempts to use economic means, its ultimate goals are political or social.

Another form of legal boycott, defined as Constitutionally protected speech exempt from the Sherman Antitrust Act, is the boycott of government when there is no economic motive. The government is not a competitor or a customer or engaged in any commercial relationship. And the Constitution always overrides mere legislation.

The secondary boycott is an attempt by the offended party to coerce a third party into joining the boycott, or to boycott that third party if it does not join. This is the type of boycott that the Federal Trade Commission (FTC) found Toys "R" Us had engaged in. Initially, the Sherman Antitrust Act outlawed both types of boycott. Section I of the act defined price fixing, agreements to share markets, and combinations to boycott as pernicious restraints of trade that were absolutely illegal.

A combination could consist of as few as two persons (individual or corporate). The Danbury Hatters' Case (*Loewe v. Lawler*, 1902) arose when the hatters' union boycotted the products of a Danbury, Connecticut, hatmaker. The manufacturer sued, and the court ruled in 1908 that the boycott violated the Sherman Act and that the individual members of the union were liable for treble damages. Not until the Norris-LaGuardia Act of 1932 did unions find relief, and that lasted only until the Taft-Hartley Act (1947) and the Landrum-Griffin Act (1959) reestablished the prohibition on secondary boycotts. Although the laws remained in effect into the 21st century, enforcement was rare.

When the federal government used the Sherman Act to break up Standard Oil in 1911, the U.S. Supreme Court ruled that the oil monopoly was clearly a violation of the act, but Chief Justice Edward D. White's court softened the law by establishing the concept of reasonableness.

Not all combinations in restraint of trade were illegal, just unreasonable ones. Defining “reasonable” has been an ongoing legal process since then. Within the limits of the Sherman and Clayton antitrust acts, there are specific restrictions on the boycott as a tool against economic competition.

For instance, when Toys “R” Us and the toy manufacturers joined to keep the warehouse clubs from receiving the popular toys, that was a group boycott, a violation of antitrust law. Other cases in this category have occurred frequently when trade associations—pharmacists, dentists, and others—have objected to reimbursement rates and decided at their meetings that they would refuse to provide the services for which they deem reimbursement to be inadequate. The collective action has an adverse effect on both the state and other reimbursing agents as well as on the consumer. It is an illegal boycott, an attempt to restrain trade.

Group boycotts are also illegal if they force the boycotted party to pay higher prices, or prevent or hamper a competitor’s entry into competition. When medical doctors combine and boycott for the purpose of keeping a managed care facility out of their territory, or when retailers decline collectively to conduct business with a manufacturer that also wants to do business with a competitor, that is an illegal boycott. Generally, the rule is that if the boycott affects price competition and has no other public good, then it violates the antitrust acts. It is also illegal to bar potential competitors from access to necessary competitive information. It is not a violation for a company to agree with another company, when the former sells a subsidiary to the other, not to raid the subsidiary’s employees for a given period of time. This action is rather a positive enhancement of trade.

## ILLEGAL BOYCOTTS OVERSEAS

In the 1970s, the illegal boycott laws expanded to cover participation by American citizens in overseas boycotts. The laws were the 1977 amendments to the Export Administration Act (EAA) and the Ribicoff Amendment to the 1976 Tax Reform Act (TRA). These laws were passed to ensure that U.S. firms did not participate in boycotts that the U.S. government did not support. The purpose was not primarily economic, although one applicable section of U.S. Code did pertain to restrictive trade practices; rather it was an attempt to retain control

of foreign policy and to prevent American businesses from being tools of policies counter to those of the U.S. government.

The immediate trigger was the Arab League boycott of Israel, but the laws covered all foreign boycotts not supported by the United States. The laws applied to all U.S. companies and individuals and foreign affiliates—even offshore businesses that did not conduct transactions in the United States. Specific prohibitions included boycotting Israel or blacklisted companies, discrimination against individuals on the basis of race, religion, national origin or nationality, and providing such information about Israel or a blacklisted company or person. Companies were barred from accepting letters of credit that specified these terms. Boycott related agreements could cost tax benefits, but there was no legal penalty.

In summary, the tendency of American corporations and trade associations to serve their own interests first has led to a highly complex, almost esoteric, body of law as litigation establishes the niceties and the technicalities of what is, and what is not, an illegal boycott. Generally, though, a group boycott must be an agreement among competitors to not deal with or otherwise bar a specific entity for commercial reasons. And the boycotting group must have economic significance, that is, the ability to alter competition through their acts, or the boycott is moot. Theoretically, an illegal boycott is well defined. In practice, because evidence is rarely complete and motives are almost never pure, application of criteria is quite difficult, and determination that a boycott is illegal commonly requires resolution through the courts.

## SEE ALSO

Federal Trade Commission; illegal competition; antitrust; Sherman Antitrust Act.

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## Braithwaite, John (1951–)

IN 2003, John Bradford Braithwaite was a professor and federation fellow in the Law Program at Australian National University's Research School of Social Sciences. Braithwaite also served as the chair of the Regulatory Institutions Network. He was educated at the University of Queensland, where he received his Ph.D. in sociology in 1977.

Braithwaite is a well-known and highly respected scholar in the field of criminology as a pioneer of new research and theories in white-collar crime. In his book, *Corporate Crime in the Pharmaceutical Industry* (1984), Braithwaite reports: "Phar-



John Braithwaite has pioneered white-collar crime research in pharmaceutical and healthcare industries.

maceutical companies face great temptations to mislead health authorities about the safety of their products. It is a make-or-break industry. Many companies get virtually all their profits from just two or three therapeutic winners. Most of the data that the Australian Drug Evaluation Committee relies upon in deciding questions of safety and efficacy is data from other countries, particularly the United States. Inquiries into scientific fraud in the United States have shown there is a substantial problem of fraud in safety testing of drugs in America, just as has been documented in Japan."

Braithwaite's other books and work focus on corporate crime and accountability, and more recently, restorative justice and responsive regulation (examinations of retribution versus restoration in corporate criminal punishment).

In addition to his position at Australian National University, he has held a number of prestigious academic and professional appointments. These include a 2001 visiting research professorship in the law school at New York University, a visiting fellowship at the American Bar Foundation, 1988–94; directorship of the Australian Federation of Consumer Organizations, 1982–84; criminologist at the Australian Institute of Criminology, 1978–82; and a Fulbright postdoctoral fellowship and visiting lecturer in the University of California, Irvine, program in social ecology. He has also served as an officer or consultant to many government agencies, as well as on the editorial boards of several academic journals.

Braithwaite is the recipient of numerous academic awards and distinctions given by academic as well as practitioner-based organizations. His notable awards include the Donald R. Cressey Award for his contributions to white-collar crime education and prevention, given by the Association of Certified Fraud Examiners in 1988, and the Outstanding Scholarship Award of the Society for the Study of Social Problems, given in 1990 for his book *Crime, Shame and Reintegration*.

His research also related to white-collar crime has focused on the topics of corporate crime control, regulation, punishment, public policy, and compliance. His studies of industry-specific white-collar crime have focused on healthcare, including research on the nursing home and pharmaceutical industries. Apart from his distinguished research career, Braithwaite has been a valued mentor for aspiring criminologists.



## SEE ALSO

Australia; pharmaceutical industry; compliance programs; Fisse, Brent.

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## Brazil

BRAZIL IS A NATION mired in the white-collar crime of political corruption. The United Nation's Global Program Against Corruption defines corruption as the "abuse of power for private gain" and includes both the public and private sector. Although perceived differently from country to country, corruption tends to include the following behaviors: conflict of interest, embezzlement, fraud, bribery, political corruption, nepotism, sectarianism, and extortion.

The longest running story of political corruption involves former president Fernando Collor de Mello. An otherwise obscure governor of the state of Alagoas, he was propelled into the national scene single-handedly by the media giant TV Globo as its champion to defeat the Workers' Party candidate Luiz Inácio da Silva.

Upon securing the presidency, Collor de Mello apparently went on a binge of corrupt extortions through his adviser Paulo César Farias with barely any attempt to be subtle or secretive (namely, he made direct payments in the form of checks). In September 1992, Collor was impeached following a vote of 441 to 38 by the Chamber of Deputies of

the Brazilian legislature on charges of corruption. Collor, while maintaining his innocence, stepped down, allowing Vice-President Itamar Franco to become the country's acting president.

In December 1992, at the opening of his impeachment trial by the Brazilian Senate, Collor resigned as president of Brazil. The Senate convicted Collor of the corruption charges by a vote of 76 to 3. The verdict barred him from holding public office for a period of eight years. Collor also faced criminal prosecution stemming from the corruption charges.

Collor was acquitted of corruption by the Supreme Federal Tribunal on the grounds of insufficient evidence. Rosane Collor, wife of the president, was also convicted and sentenced in *abstentia* to 11 years in prison for corruption. In June 1996, Farias was found shot to death with this girlfriend in a beach house in Maceió, state of Alagoas, sometime before he was scheduled to testify in court about corruption during the Collor administration.

Such tales of high crimes are not limited to one presidential family. In 2002, presidential hopeful Roseana Sarney (daughter of a former president) abruptly discontinued her presidential campaign after a police raid on her company uncovered a mysterious \$558,000. Sarney had been running on an anti-corruption platform, and her various explanations of the money were unbelievable.

Corruption exists not just at high places in Brazil. On a daily basis, the media have no trouble finding dozens of stories of corrupt practices, ranging from high-level bureaucrats who accept bribes to award contracts or cut red tape, to political hacks who are paid for no-show government jobs, to minor functionaries who can expedite license and visa applications, to traffic policemen who can ignore traffic violations for a fee.

In a 2002 study, a survey was conducted of 5,312 persons between the ages of 12 to 64 years-old. The survey was done in nine major cities (Belo Horizonte, Brasília, Curitiba, Fortaleza, Porto Alegre, Recife, Rio de Janeiro, Salvador, Sao Paulo) as well as the interior of Sao Paulo state and south/southeastern Brazil. During the survey, the respondents were shown a statement: "The first thing that the government needs to do is end corruption."

Of the respondents, 82 percent said that they "completely agreed" and 12 percent said they "somewhat agreed." No other issue (be it employ-



*The vast city of Sao Paulo, Brazil, with 10 million residents, contends with the effects of political corruption mixed with organized and violent crime in the country's major cities.*

ment, education, or national security) garnered as much support.

In Brazil, as in other countries, corruption breeds distrust of public institutions, undermines ethical principles by rewarding those willing and able to pay bribes, and perpetuates inequality. Individuals who wish to conduct their affairs fairly and honestly are demoralized and lose faith in the rule of law. Economic competition is distorted and public funds are squandered. As institutional and market reforms may lose credibility in the eyes of the public, processes of democratization (which should eventually reduce inequalities and improve transparency and accountability) lose momentum. Until the corruption issue is addressed, all other processes are ineffective.

## VIOLENT CRIME

The hazards of corruption in Brazil spill over into other criminal activities. In the 1990s and early 2000s, Brazil experienced levels of violence on par with those seen in Colombia and South Africa, two of the most violent societies on earth. The murder rates of the southern Brazilian states of Sao Paulo and Rio de Janeiro are four to five times higher than those in the United States.

The reason for such levels of violence, including instances of torture and summary executions, can be traced to the battle for drug profits and territories, pitting criminal gangs (narco-traffickers) against one another, and against certain corrupt segments of the police looking for a share of illegal profits.

Four national gangs currently dominate the country's drug underworld. Born in prison, they have established networks of affiliates and allies throughout the country. Moreover, they have transformed the country's prison system into their fiefdoms.

For many residents of impoverished areas, the gangs are a lesser of two evils given that they provide jobs, certain charity services, and sponsor social events such as dances and youth soccer, rather than the state's no-services and corruption. Although altruism plays a part in their social investments, the gangs' social contributions also buys the loyalty of many slum-dwellers. They are modern-day Robin Hoods, extremely popular in the slums where they make important investments, something the government rarely does. As a result, many slums are now no-entry zones for the government authorities, and are sometimes ringed by armed roadblocks.

The violence has steadily increased since the mid-1990s as the stakes grew larger and the weapons more powerful. Brazil is simply awash in weapons, and the narco-traffickers have endowed themselves with some of the most sophisticated small arms available. The problem is, certain segments of the police and military are more interested in the drug business than they are in law enforcement. As a result, some police have launched assaults against those who have refused to pay them protection.

## SEE ALSO

bribery; corruption; drug trafficking; South America.

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## breast implants

THE INTRODUCTION OF silicone-gel implants in the early 1960s was a boon for manufacturers who accurately predicted a lucrative market, and for plastic surgeons who sought an effective and safe method to augment and replace breasts. Sales of the devices soared even as complaints of breakage and leakage began to emerge. Reports began surfacing in the mid-1980s that revealed a number of detrimental health effects which appeared to be directly associated with the silicone-gel breast implants.

After a long and heated battle over product safety, in 1992 the Food and Drug Administration (FDA) limited the use of silicone-gel breast implants to women who needed reconstructive surgery after mastectomies because of the high risk of possible health dangers. The debate over the marketing and safety of the devices continues as the FDA considered a 2002 application submitted by Inamed Corporation for approval to reintroduce silicone-gel implants.

### IMPLANT BACKGROUND

The history of the silicone-gel implant is convoluted and controversial. Dow Corning, based in Midland, Michigan, and a joint venture of Dow Chemical, introduced the silicone-gel implant to an unregulated market in 1963. Direct silicone injections, undergone by as many as 50,000 women, had been a popular method of breast enlargement until horror stories of blindness, gangrene, pneumonia, and even death promoted many state legislators to enact laws banning the practice. Dow Corning became involved in the practice through sales of in-

dustrial-grade silicone that was being sterilized and injected by doctors across the country. The company eventually was indicted by a federal grand jury in 1967 for shipping a non-approved drug three years earlier. Dow Corning, claiming to have no knowledge of what the silicone was being used for, pleaded no contest to the charges and paid a \$5,000 fine.

The legitimate marketing of silicone breast implants by Dow Corning was launched under the trade name Silastic. The new implants contained sealed silicone-gel in a sack of silicone sheeting that was designed to prevent fluid escape, maintain shape, and mimic the feel of actual breast tissue. Orders for the product flooded the company, and by 1967 an estimated 40,000 women had silicone breast implants. Product sales represented a billion-dollar business for Dow and five other corporations, particularly during the peak years for implants from 1979 to 1993. The Department of Health and Human Services estimated that by the early 1990s, one million women had silicone-gel breast implants, with the majority of cases involving elective augmentation surgery.

### IMPLANT EFFECTS

Consumer complaints that the implants were leaking, hardening, and rupturing continued to haunt the market. As early as 1982, physicians and researchers began to claim that the implants were associated with connective tissue diseases (CTD) and health problems connected to autoimmune disorders, including lupus, scleroderma, polymyalgia, and rheumatoid arthritis.

Many of the complications resulted in permanent disabilities and disfigurement. When silicone-gel implants ruptured, the surrounding tissue became infected with silicone and required extensive surgery. Between 1983 and 1991, the FDA received 5,000 implant-related complaints. Many consumers believed that manufacturers marketed the product without warnings of known risks and acted in bad faith.

Dow Corning was accused of withholding information on the long-term toxicity of silicone. Preliminary research by Dow showed that laboratory animals suffered from birth defects, nervous system disorders and even death as a result of the implants. A 1995 research study of 775 patients found that 91 percent of the polyurethane-coated silicone im-

plants on average had ruptured and 31 percent of the conventional silicone devices had ruptured. Internal memos from Dow Corning addressed the “bleeding” silicone problem and directed sales representative to clean any oil from the implant before showing it to prospective buyers. Corporate communications suggest that the company had been aware of leaks and ruptures since in the early 1970s and had manipulated the quality control records of the product. Finally, in 1985, package inserts included printed warnings of possible immune system diseases.

## REGULATION AND LAWSUITS

The U.S. government, despite mounting evidence, allowed the continued sales of the silicone-gel product. The implants were not regulated as medical devices until 1976 after the passage of the Medical Device Act, but the FDA allowed the manufacturing and sale of the implants without scientific research on safety since they were already on the market. In 1982, the classification for silicone implants changed to a more rigorous category that required information on the safety of the product. The FDA requested details from the manufacturers but allowed more than two years for the testing.

The first lawsuit against Dow Corning was filed by Maria Stern whose autoimmune disorder was said to be caused by her implants. The jury awarded her \$2 million in 1984 and the judge took note of the “corporate malice” by Dow Corning, and labeled the company’s behavior as “highly reprehensible.” Other lawsuit jury awards and out-of-court settlements followed. In 1991, Mariann Hopkins received \$840,000 in compensatory damages and \$6.5 million in punitive damages. Hopkins had silicone-gel breast replacements implanted in 1976 after a double mastectomy. She later developed a devastating immune disorder from the silicone exposure.

In the Hopkins case, the U.S. District Court found that Dow Chemical was guilty of fraud, malice, and oppression, however, the evidence from the trial, including internal memos from the company, was sealed by a court-issued protective order. In another case, Pamela Johnson’s suit resulted in a \$25 million verdict against Bristol-Myers Squibb. Baxter Healthcare was ordered to pay \$2.27 million to a woman whose implants ruptured.

By 1997, at least 748,000 claims had been filed by women who said the silicone-gel implants were

the cause of their illnesses. Also that year, a jury in New Orleans, in the first class-action lawsuit, found Dow liable for the dangerous implants and held that the company had purposely hid information that the silicone gel might cause harm.

The action was filed on behalf of 1,800 women in Louisiana who claimed that the silicone seepage caused immune system-related diseases. During the trial, Dow Chemical asserted that it never made or tested the implants, though the company owned 50 percent of Dow Corning. The plaintiffs argued that Dow Chemical performed toxicology tests on silicone in the 1940s and 1950s that showed the potential dangers of the chemical. The company claimed that the experiments were unrelated to implants and that scientists were testing the effect of industrial silicone on workers. The California State Supreme Court ruled that Dow Chemical could not be held liable for the harmful actions of Dow Corning.

In 1994, a \$4.25 billion class-action settlement was approved. Dow Corning sought Chapter 11 bankruptcy protection in 1995 in a self-protective move to avoid liability; though the sale of the implants represented only a small portion of company’s profits, the damage to its reputation was devastating. Three years later, the company offered \$3 billion to 177,000 claimants to settle the claims. The settlement agreement would compensate women based on the seriousness of injury, with a maximum compensate of \$300,000 for women who had severely debilitating diseases; up to \$5,000 for removal of the implants; and \$25,000 as compensation for ruptured implants. The litigation in these cases, including an estimated 13,000 lawsuits just against Dow, cost manufacturers billions of dollars and untold damage to corporate reputations.

The scientific evidence connecting silicone implants and CTD remains controversial and inconclusive. A 1996 research study at Harvard Medical School, partially funded by Dow Corning, found a “small but statistically significant increased risk” of immune-system illness. The data showed little hazard; in fact, of the 10,830 women who had received implants, only 231 reported that they had been diagnosed with CTD. More than 20 studies found no evidence that implants were linked to lupus, scleroderma, and other diseases. A 2000 study by the Institute of Medicine concluded that the silicone implants were not causally related to CTDs such as lupus and rheumatoid arthritis, though breast im-

plants can cause numerous localized problems from rupture. The study has been interpreted as a sign that the implants can be safely manufactured and in July 2003, the FDA began review of an application to re-approve silicone-gel implants, despite numerous protests from many women's groups. The application was denied in January 2004.

#### SEE ALSO

Dow Chemical; Food and Drug Administration; juries and awards.

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## Bre-X

**BRE-X MINERALS LTD.** was a small Canadian gold exploration company that committed the world's biggest mineral stock fraud in history. Bre-X became the star of investors in the gold industry after it announced a major gold deposit discovery, perhaps the largest ever discovered, in properties it was mining in the Busang area on the island of Borneo in East Kalimantan, Indonesia. It was later discovered that little, if any, gold was actually found in these properties. Some people, including insiders, became quite wealthy from the stock-play. The Bre-X fraud has been the subject of at least six books published about the scandal.

The Bre-X tale began in 1993, when David Walsh, a veteran stock promoter, traveled to Indonesia and met John B. Felderhof, a well-known geologist, who convinced Walsh to bet his company on Busang. In August 1993, Bre-X began to explore in the Busang area, and was reporting favorable drill results.

By early 1997, it claimed to have proven the existence of 71 million ounces of gold, worth about \$25 billion, and estimated that there was at least 200 million ounces present at Busang. As a result, the

Bre-X stock rose so high that it qualified for inclusion in the TSE 300, which caused index funds and all portfolios tracking the index to purchase the stock. To produce such a huge deposit, the Indonesia government required that Bre-X share some of the fortunate excess with the people of Indonesia, and with Barrick, a firm tied to Indonesian leader Suharto's ambitious daughter Siti Rukmana.

#### NO DEAL

But Barrick could not negotiate a deal acceptable to all parties. With Suharto's close confidant Mohamad "Bob" Hasan stepping in with the deal, the American firm Freeport-McMoRan Copper & Gold was eventually selected as Bre-X's partner in the Busang project. Freeport first undertook its own due-diligence drilling and reported that its analyses of seven core samples "indicate insignificant amounts of gold." That news came one week after the announced death of Bre-X's chief geologist Michael de Guzman, who reportedly fell to his death from a helicopter while traveling to Busang to meet with Freeport's due diligence team to discuss Freeport's assay results. Forensic Investigative Associates conducted an independent investigation into the scam and concluded that the company had "improved" the samples from the time they were collected until they were turned over to a down-river lab for analysis. Forensic Associates believed Walsh (and the other Canadian employees) did not know about the samples. The next day, the \$6 billion (Canadian) Bre-X stock lost almost all of its value.

An independent company, Strathcona Mineral Consultants, was commissioned to conduct an independent study of the situation. After their study, Strathcona concluded that "an economic gold deposit has not been identified in the South East Zone of the Busang property, and is unlikely to be."

Prior to the disclosure of the truth, Walsh and Felderhof sold large amounts of their personal stock in Bre-X, reaping millions of dollars for their own benefit and at the expense of Bre-X investors, who lost about \$3 billion when the scam was revealed in the spring of 1997. This incident caused a massive shattering of investor confidence and tarnished the reputation of the securities industry.

#### SEE ALSO

securities fraud; stock fraud; Canada; Securities and Exchange Commission; Canadian Mining Scandals.

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## bribery

BRIBERY OCCURS when something of value is improperly given to a public official in exchange for preferential treatment, or when officials use their position of power for personal gain. Bribes represent a corruption of a relationship of trust.

According to Transparency International, a non-governmental international organization devoted to combating corruption, bribery has several damaging effects. It undermines societal integrity, causes human rights abuses, corrupts democratic systems, discriminates against developing countries attempting to compete on a global scale, and disrupts free market operations. Within business, politics, and even within the criminal justice system, the offering of bribes has a long-established history to the point of being an institutionalized practice. The offering of bribes generally gives a distinct advantage over competitors by allowing an individual or organization to gain unfair benefits or avoid costs. Between 1994 and 1998, U.S. governmental officials found that bribes influenced 239 international contract competitions. Not surprisingly, the contracts were generally given to those who offered the bribes. In all, these 239 bribes accounted for \$108 billion.

Within the United States, laws and statutes have been enacted to deal with bribery of both domestic and foreign officials. Internationally, similar laws have been recently developed to combat international bribery of foreign and/or public officials. Traditionally, most bribery offenses in the United States have been settled under section 201 of Title 18.

Enacted in 1962, section 201 criminalizes both the behavior of those who give or offer a bribe as well as those who accept one. In addition, this statute addresses gratuities given to witnesses for in-

fluencing their testimony. Under section 201, bribery is defined as the exchange, offering, or promise of anything of value such as money or favors to a public official in order to corruptly influence a social policy or act.

The federal courts have ruled that "value" is not necessarily limited to commercial or financial value but can include a simply promise of future employment. In terms of public officials, the bribery statutes maintain that officials are anyone who perform some federal duty or possesses some level of responsibility under a federal program or policy. While the original rhetoric contained within the bribery statutes applied only to federal officials, by 1984 Congress extended these laws to include any state or local agent who received \$10,000 or more in federal funds. Under section 201, an official act involves any decision, matter, or action that is pending and which can be unduly influenced by a public official. Whenever an attempt is made to influence a public official to defraud the government, it is considered a corrupt act or bribe.

## INTERNATIONAL BRIBERY

While there is a long history of bribery of domestic public officials, not until after World War II as the move toward globalization took place, did U.S. statutes deal with the bribery of foreign officials. Advancements in technology and resources allowed economically developed countries like the United States to establish business relations with foreign countries. Within these foreign markets, American companies encountered an environment that encouraged the bribing of foreign officials in order to receive contracts, permits, and other business-related advantages.

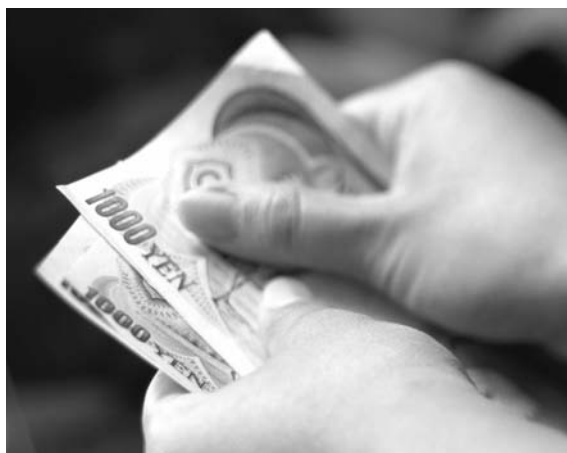
In an effort to criminalize bribe payments to foreign officials by American corporations and individuals, in 1977 Congress enacted the Foreign Corrupt Practices Act (FCPA). The FCPA provisions clearly specified that bribes occur whenever: 1) a domestic or foreign company or any U.S. citizen; 2) offer, promise, authorize, or deliver a payment of something of value; 3) to a foreign official, officials of a public international organization, political candidate, or political party; 4) within U.S. territories or to any American official outside the United States; 5) to corruptly induce or influence an official to act or refrain from acting or to gain any improper advantage; 6) to assist the company in

obtaining, retaining, or directing business to any other interested persons or parties. The FCPA guidelines also considered any knowledge of payments knowingly directed or made to third parties as an act of bribery. This provision was designed to encourage company officials to report any acts that may be considered a bribe or violation of FCPA policies. Thus, anyone with direct or indirect knowledge of bribes would be subject to criminal sanctions.

One of the unintended consequences of the FCPA was that it left U.S. companies at a disadvantage in the international markets because their foreign competitors were not subject to the same aggressive legal guidelines. That is, foreign businesses were able to offer bribes without penalty since no criminal statutes existed in their own territories to sanction or punish bribery. By 1988, Congress amended the FCPA and urged the president to encourage American trading partners or members of the Organization of Economic Cooperation and Development (OECD) to pass anti-corruption laws to address fraudulent international business dealings. Founded on December 14, 1960 and based in Paris, France, the OECD was originally comprised of 20 countries, including 18 European countries, Canada, and the United States. In 2003, there were 30 OECD members comprised primarily by economically developed countries that house the majority of multinational corporations operating in the international markets.

From the perspective of the U.S. Congress, international corruption reduced fair competition, undermined economic development, and interfered with free business markets. In particular, Congress argued that bribery of foreign public officials produced unfair advantages to countries unrestricted by criminal statutes and regulation. Congress sought to extend the FCPA guidelines against bribery to foreign competitors or any country dealing in foreign markets.

To address U.S. concerns about international bribery, on November 21, 1997 the OECD adopted the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention). This convention made the bribery of foreign officials an international crime among 34 member countries. Similar to the guidelines of the U.S. FCPA, the convention states that the intentional offering, promise, or giving of money or something of value to a foreign official to



*Though illegal in the United States, the paying of bribes can be a way of doing business in other countries.*

obtain or retain an improper advantage is prohibited and shall be considered a bribe or violation of the convention statutes. Under the rhetoric of the convention, “foreign official” includes any person holding a legislative, administrative, or judicial office of a foreign country, any person exercising a public function for a foreign country, and any official or agent of a public international organization.

Article 1 of the convention also specifies that “improper advantage” refers to receiving gains that an individual or company would not otherwise receive or clearly not entitled to have. While the OECD Convention did not attempt to require strict uniformity or drastically change the legal system of every member nation, the guidelines set forth were intended to establish consistent international regulation of illegal business transactions such as bribes. Punishments or penalties require that countries be able to seize or confiscate the bribe and bribe proceeds and if countries are unable to meet such criteria then they should obtain monetary sanctions comparable to the bribes offered.

While the FCPA of 1977 helped to influence the OECD Convention guidelines, the OECD had a reciprocal affect on the 1998 amendments of the FCPA. Adopting similar OECD Convention stipulations, the 1998 FCPA amendments allowed U.S. attorneys to prosecute “any person” who commits bribery on U.S. territory.

Prior to this revision, only American individuals or companies that offered bribes could be prosecuted under the FCPA guidelines. Furthermore,

the 1998 amendments expanded the authority of the FCPA to include any person or entity offering or accepting bribes in territories outside the United States but that involved U.S. interests. In this way, the OECD influenced the FCPA by granting U.S. prosecutors greater authority to enforce any violations against bribery statutes.

#### SEE ALSO

corruption; Foreign Corrupt Practices Act; criminal facilitation; globalization.

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## Brown Lung

BROWN LUNG DISEASE is a respiratory disorder associated with the processing of cotton, flax, hemp, or other fibers, and is common among textile workers. The term *Brown Lung* is often mistakenly used for either of two different diseases, according to the book *The Cotton Dust Papers*: "... Mill Fever, which is an acute response to the biologically active material—fungi, bacteria—in contaminated cotton, and byssinosis, which is related to the component of cotton dust emanating, it is believed, from the endotoxins of the cotton plant itself."

Although it was commonly called by different names, including Mill Fever, in different areas and times, this affliction was first recognized in the 1600s and was widely known in England and Europe 200 years later.

Until the relatively recent past, it was believed to be limited to European mills and foreign cotton. Americans with shortness of breath, sluggishness,

and asthma-like attacks were believed to be suffering from other afflictions.

In the early 1900s, following a series of autopsies which showed lung damage for which there was no apparent physical cause, Britain began researching the cause of the problem. After determining that the victims had worked in the dustiest part of textile mills, in 1941 the British Parliament began giving benefits to completely disabled victims who had at least 20 years' exposure to cotton dust.

#### HISTORY OF THE AFFLICTION

One of the earliest mentions of the affliction in the United States is an article published in 1940 in the trade journal *Textile World*. Other studies using different findings and methodologies were done in the 1940s. Following another British study, a rash of research was done in America from the 1950s through the 1980s. Brown Lung was not recognized as an official occupational hazard in the United States until 1977. At that time, only two American victims had won settlements from the lung disease.

As the harvest and ginning of cotton became more mechanized, the amount of contaminants in the cotton bales increased and Brown Lung became more prevalent. In 1981, estimates based on government and labor union studies indicated at least 20 percent of American textile mill workers had byssinosis from breathing in microscopic particles of leaves and stems coming from processing bales of raw cotton fiber.

Brown Lung was one of the health hazards which inspired the Occupational Safety and Health Act (OSHA) of 1970. This act allows the U.S. government to set standards to protect workers from substances that are toxic. Bureau of Labor statistics cited in the 1970 hearings showed almost 400,000 cases of occupational disease. It was in the 1970s that the name Brown Lung was coined. Credit for the phrase is given to Ralph Nader, who wrote a 1971 article which focused national attention.

Although state workers' compensation systems began in 1911, they did little to help victims of occupational diseases such as byssinosis. Even though the system was supposed to be no-fault, 90 percent of occupational lung-disease claims were contested well into the 1980s, and those that were won by the victims often took more than a year to settle. Part of the difficulty was that the burden of proof of disease was on the plaintiff to show she had contracted



the disease through her occupation. In the late 1970s, only about one-tenth of the (eventually) successful accident claims under workers' compensation was contested by employers. However, employers contested three-fifths of disease claims in general, and nine-tenths of the dust claims in particular during this same time period. These contested claims presented special difficulties for the claimants: Procedural points were especially hard-fought by both sides because so many of these points were setting precedents that would either help one side or the other in the next case. Moreover, the workplace had usually changed a great deal since the employee left, sometimes a period of years before. Access to these work sites was not always readily available, and sometimes there were indications of retribution against witnesses providing testimony for the plaintiff.

In 1980, the North Carolina Supreme Court extended the statute of limitations to one year after the victim had been notified by "competent medical authority" that she had byssinosis. By August 1981, 707 claimants had been awarded \$8.01 million. 1981 brought a decision by the North Carolina Supreme Court that textile workers were only entitled to partial compensation for byssinosis if their condition stemmed partly from causes other than exposure to cotton dust.

In June 1981, the U.S. Supreme Court, in a 5-3 decision, ruled that the OSHA does not require government regulators to consider the costs to industries when mandating compliance with standards. The American Textile Manufacturers Institute and 12 textile companies had filed suit against OSHA, stating that the required dust-level standards were too strict. The plaintiffs claimed that the air-filtration systems required to meet the new standard would cause them unreasonable costs and might drive small textile companies out of business. The manufacturers' attorneys further argued, without success, that according to the 1970 law, OSHA had to assure that the health regulations benefits had a reasonable ratio to the compliance cost, but the cost/benefit relationship of this standard did not.

Interestingly, the equipment which textile manufacturers installed in order to comply with the Supreme Court's ruling ultimately improved the productivity of the factories and the quality of the products, as well as reduced the amount of harmful cotton dust to which the workers were exposed.

By June 1987, 3,416 worker compensation claims had been filed in North Carolina, with 1,835 of these winning settlements or awards totaling \$30 million. Although South Carolina did not keep figures, the Brown Lung Association, an advocacy group for textile respiratory victims, estimated 350 cases had been filed in that state through 1982 with 180 winning about \$3.5 million.

Even though state workers' compensation systems had disbursed millions of dollars to settle byssinosis claims by the early 1990s, that was only a small part of the cost to the victims, and relatively few actually received these benefits. Many were denied, did not file, or died before they could be awarded compensation.

#### SEE ALSO

Occupational Safety and Health Act (OSHA); Nader, Ralph; juries and awards; negligence.

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## Buffalo Creek

THE DAM BROKE SHORTLY after 8:00 on a Saturday morning. On February 26, 1972, a wall of mining waste and water estimated at 30- to 50-feet-high roared down Logan County's Buffalo Hollow and through the West Virginia villages of Lorado, Riley, Braeholm, Accoville, Pardee, and Man.

Down the 17-mile valley poured 130 million gallons of water, sludge, cars, houses, trees, bodies, and more. When it was over, 80 percent of the 2,200 homes in the valley were gone or uninhabitable,

thousands of people were homeless, many lost all their possessions, 16 communities were destroyed, and 125 people were killed.

Pittston Coal Company bought the dam in 1970 and continued the common practice of piling mine refuse, mostly coarse coal fragments and shale, across valleys to get rid of the waste and provide settling ponds for water purification. The water level of the mile-long body of acidic water behind the dam had been alarmingly high after three days of heavy rain combined with melting snow. According to William Davies, the U.S. Geological Survey geologist investigating the disaster, the company decided to cut a spillway through the top to try to increase the dam's stability. Unfortunately this weakened the dam instead, and released 20 million cubic feet of thick, sludgy water that raced down the valley at speeds of nearly 30 miles-per-hour. It was weeks before all the bodies were found, some of them miles downstream.

Investigation into the causes of the flood, one of the worst coal-mining disasters in U.S. history, brought allegations of faulty construction of the dam, including violation of several state and federal building codes. Officials were accused of not showing the dam on maps given to the West Virginia Mines Department. Also accused of unwittingly contributing was the Bureau of Mines which failed to enforce federal prohibition against refuse banks, and the West Virginia Public Service Commission which did not enforce dam-construction permit laws. A special Logan County grand jury, however, decided that no criminal charges should be brought against these parties.

Reporting that they still faced feelings of guilt, nightmares, and other terrors, survivors sued the Pittston Company, asking for recompense for "psychic impairment" as well as property loss. Pittston Coal representatives, almost immediately after the disaster, had claimed the flood was an "act of God" and therefore not the company's responsibility. However, an out-of-court settlement in 1972 provided 625 adult survivors \$13,500,000. A class-action suit was also filed against Pittston Company on behalf of 348 children who survived the Buffalo Creek flood. In June 1974, this suit was settled out of court for \$4,800,000. Presiding U.S. District Judge John Copenhaver, Jr., ruled that five children in utero at the time of the flood should share in the settlement because of an indication by medical evidence that unborn children could be affected by

psychological trauma. Other survivors settled with the company independently.

Before leaving office in 1977, the West Virginia governor, Arch Alfred Moore, Jr., signed a settlement with Pittston for the coal-mining company to pay West Virginia \$1 million for clean-up costs resulting from the flood. In 1987, the U.S. Supreme Court required West Virginia to pay the U.S. Army Corps of Engineers \$10 million, including \$5.8 million in interest, for clean-up and relief efforts by the U.S. Army Corps of Engineers following the Buffalo Creek flood.

A further response to this tragedy was a 1977 federal law requiring thousands of acres of strip-mined land be returned to its original contour when the mining was finished. Unfortunately, mountain-top removal is specifically exempted.

#### SEE ALSO

coal mining; corporate liability; Mining Safety and Health Act.

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## Bush, George H. W. (1924–)

AS A YOUNG MAN, George Herbert Walker Bush, the future 41st president of the United States, served in the U.S. Navy during World War II as a pilot before entering college. Like his father Prescott, Bush attended Yale University and was a member of an elite society, Skull and Bones.

Bush began his political career in the 1960s, serving two terms as a representative from Texas before holding various high-level positions within the federal government including: ambassador to the United Nations, chairman of the Republican Na-

tional Committee, chief of the U.S. Liaison Office to China, and director of the Central Intelligence Agency (CIA).

Focusing on Bush's public record in white-collar crime, numerous examples can be found to illustrate Bush's alleged involvement in crimes ranging from political assassination to software piracy. It should be noted Bush's involvement in such crimes may, by no means, be unique to his presidency. An equally damaging, if not similar, report could be presented for many elite leaders and presidents. But it is Bush's unique background, and avoidance of culpability, that illustrates specific criminal cases. For example, as CIA director, Bush maintained a policy of disinformation and secrecy. Under Bush, the CIA participated in such crimes as drug-trafficking and organized assassinations. One of these assassinations took place in September 1976 when Chilean dissident leader Orlando Letelier was killed by a car bomb in Washington, D.C. Under Bush, the CIA submitted a false report on the assassination of Letelier that deliberately misled the FBI investigation. Twenty-four years later, in September 2000, a report to Congress revealed that the mastermind of the assassination was a Chilean intelligence chief, who was later found to be a paid asset of the CIA under Bush.

Bush was elected vice president in 1980, and regularly received key intelligence information while attending President Ronald Reagan daily security briefings and cabinet meetings. This high level of involvement proved damaging for Bush when the Iran-Contra scandal surfaced in 1986, involving illegal funding of anti-communist rebels, the Contras in Nicaragua. An independent-counsel investigation failed to reveal the extent of Bush's involvement in the Iran-Contra scandal, and could not derive enough evidence to indict him. Bush's interference with the investigation, coupled with his violations of non-enforceable statutes protected him from indictment.

## PANAMA

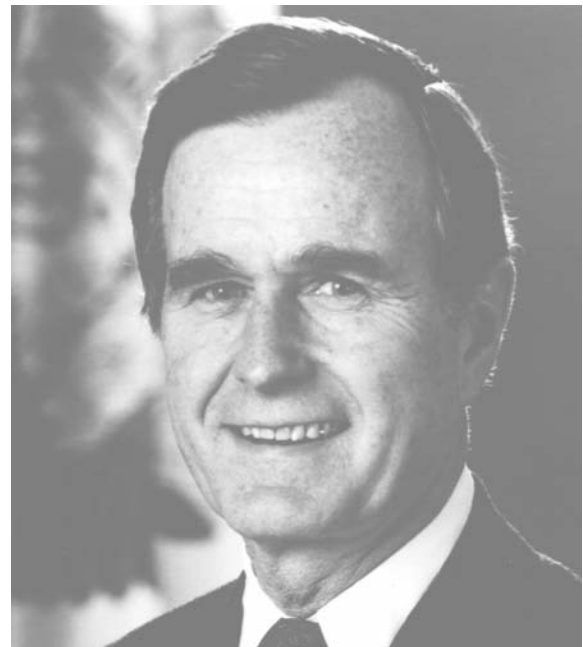
In December 1989, 12 months after being inaugurated president, Bush ordered the invasion of Panama to depose the Panamanian leader General Manuel Noriega, who was a drug-trafficker and dictator. The true reasons behind the invasion are more complex in nature. Noriega had a long history of working for the U.S. government, and for Bush.

Bush worked with Noriega during his vice-presidency in the 1980s. During the Iran-Contra scandal, Noriega was paid over \$100,000 a year by the CIA for using his drug trade as a means of supplying arms to the U.S.-backed Contras. The revelation of Bush's criminal relationship with Noriega was a crucial factor concerning the invasion of Panama.

The attack in Panama began with a massive aerial bombardment that struck both military and civilian targets. After the attack, the press and the Red Cross were prevented from entering the heavily bombed areas as U.S. military personnel incinerated and buried civilian remains. The Bush administration allegedly attempted to hide the true number of casualties inflicted in the attack, and reported a death toll of 500 to 600 individuals. However, some independent rights groups, such as the Panamanian National Human Rights Commission, estimated that 3,000 to 5,000 people were killed, and that another 25,000 people were left homeless.

## INSLAW

The Inslaw scandal began in the mid 1980s and involved the Department of Justice (DOJ) allegedly



*George H. W. Bush holds a unique record of alleged white-collar crime in his CIA and presidential legacy.*

stealing Inslaw Inc.'s PROMIS database management software, and then using it without a license. The Inslaw Company began a futile legal battle in an attempt to prove that the DOJ had appropriated the PROMIS software fraudulently. This litigation resulted in the bankruptcy of Inslaw and the validation of the government use of PROMIS.

The DOJ proceeded to use the software to create the infrastructure of the entire U.S. intelligence community. However, the true scandal concerning Inslaw software occurred when a "trapdoor" was created by the CIA and integrated into PROMIS software. The illegitimate software was then sold to foreign governments, intelligence, and police agencies. With the trapdoor modification, PROMIS had the potential to be an unprecedented global espionage tool.

The amount of harm caused by the Inslaw scandal may never surface due to the lack of hard evidence concerning the government use of PROMIS. In 1991, an investigative writer, Danny Casolaro, claimed to have "cracked" the Inslaw scandal and was compiling his final pieces of evidence on the subject. A short time after, Casolaro was mysteriously found dead in a hotel room and his documents and evidence concerning Inslaw were never recovered. The official investigation claimed that Casolaro had committed suicide; interestingly, the local police and the DOJ are still withholding information (as of early 2004) about the investigation.

## IRAN-CONTRA PARDONS

Bill Clinton defeated Bush in the 1992 presidential election. Before leaving office, on December 24, 1992, Bush pardoned Casper W. Weinberger, Duane R. Clarridge, Clair E. George, Elliott Abrams, Alan D. Fiers Jr., and Robert C. McFarlane, all of whom were involved in the Iran-Contra scandal. George, Abrams, Fiers, and McFarlane were pardoned after being convicted under such crimes as: felony and misdemeanor counts of withholding information from Congress, perjury, false statement, and obstruction in connection with a Congressional grand jury investigation. Clarridge and Weinberger were indicted and awaiting trial when they received rare pretrial pardons from Bush. Joseph F. Fernandez, another individual who was indicted in the Iran-Contra scandal, was protected from prosecution. The Bush administration refused to release classified information concerning Fernan-

dez's involvement with the scandal, leading to the dismissal of his case.

## SEE ALSO

Iran-Contra; North, Oliver; Bush, George W.; elite crime.

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## Bush, George W. (1946–)

SCANDALS HAVE become common occurrences regarding presidential administrations, but in the case of the 43rd president of the United States, one would have to look back to 1876 with the appointment of Rutherford B. Hayes to find a president so quickly surrounded with scrutiny. Even before George W. Bush became president, his administration was already shrouded with a scandalous stigma surrounding the contested presidential election results from voting irregularities on November 7, 2000.

The entire election rested on the outcome of the state of Florida, whose voting process was so flawed that it would take 33 days until Bush was awarded the victory. However, while Bush was the winner, the entire country was the victim of dubi-

ous Supreme Court rulings that effectively chose the president for the public. In addition, the voters of Florida were victimized by Choicepoint, a company hired by the state of Florida to determine who was ineligible to take part in the election due to having a felony charge on her record. The problem with Choicepoint was that it erred badly in its determinations of who could not vote. Bush's election provides an unparalleled and alarming example of how possible corporate fraud or negligence can mix with politics and affect the election of a president.

### VOTER DISCRIMINATION

The earliest problems surrounding the election between Republican Bush and Democrat Al Gore began with the hiring of Database Technologies (DBT) by Florida Secretary of State Katherine Harris, a Republican. DBT is based in Florida, and is a smaller division of Choicepoint. It was the job of Harris and DBT to go through the eligible voters list in Florida and determine if anyone was ineligible to vote, and if they came across someone who was not eligible, then they removed the person's voting rights.

At the time of the election, Florida state law prohibited convicted felons from voting. The problem with the list of people who had their voting rights taken away was that thousands of them were legally entitled to vote, yet were prevented. What adds to this embarrassment is that most of the voters who lost their rights were minorities in historically democratic counties who would have overwhelmingly voted for Gore. Over 90 percent of African-Americans who voted in the election voted for Gore.

According to acclaimed British BBC television journalist Greg Palast, Harris removed 57,700 names from the registered voters list, meaning that those names could not vote. In addition, 8,000 other names gathered by DBT were removed on the basis of having felony charges. However, these 8,000 names were not convicted felons, but rather were convicted of misdemeanor crimes, which would not prevent them from voting. Palast traced the bogus list to its originators, which were state officials from Texas who sold the list to Choicepoint.

The list of 8,000 names were predominately minority voters, as well as poor white voters, all of whom statistically voted Democrat. Following this admitted mistake, DBT and Harris came forth with

the before-mentioned list of 57,700 ineligible voters. Again, the basis of this list was that these people were convicted felons.

Following the election, Palast went through the list, discovering that 90 percent of the people on the list were actually entitled to vote and had never committed a felony. What was striking about so many people on this list (who were incidentally predominantly black voters), was that DBT had removed all voters who shared similar names to convicted felons of the same minority race. For example, a person sharing the same name as someone convicted of a felony crime, in the case that both were minorities, would have all of her voting rights removed by DBT, regardless of whether she was ineligible to vote or not. Critics pointed out DBT should have done more thorough research to determine which individual was ineligible to vote, but the company refrained from this procedure.

In total, allegations said over 90,000 people who should have been allowed to vote were prevented from voting due to DBT, mostly African-Americans and Hispanics, and all predominantly Democrats. On April 17, 2001, ChoicePoint Vice President James Lee went before Congress and admitted that ChoicePoint and DBT were only following the orders from the state of Florida, which included eliminating voters whose names matched 80 percent of that of a convicted felon's name. Since the lists handed to the DBT included a person's race, it made it all the easier to discriminate against minority or Democratic voters. When Bush was declared the victor, it was by a total of 537 Florida votes. In total, 5.8 million people voted in the state of Florida, and over 200,000 predominantly minority voters either saw their voting rights blocked or their votes not counted.

### SUPREME COURT PRECEDENCE

The Supreme Court ultimately decided that Bush was the rightful winner of the election. In a 5-4 decision, split along party lines, the justices ruled to stop the recount on December 9, 2000, at 2:20 P.M. as Gore had cut the lead down to only those 537 votes. There are two significant points regarding the Supreme Court's decision to intervene in the election. The first is that since it is the responsibility of the states to enforce their elections under state law, it is also the responsibility and duty of the state courts to make any necessary rulings on electoral

procedures. Second, the argument brought forth by the Bush team that a manual recount would violate the 14th Amendment did not follow any court precedence.

In making the claim that the 14th Amendment was being violated, the Bush team would have to prove that irreparable harm would be caused to the Florida voters by continuing the manual recount. This irreparable harm was never proven, and was rather strongly opposed since there was such a large proportion of Florida voters who wanted a recount because they felt that their votes had not been counted. In addition, the fact that Bush raises the 14th Amendment as a defense is inapplicable because he was not a Florida voter. Bush was not irreparably harmed by a manual recount. Ultimately, Bush made this claim on behalf of the Florida voters; no Florida voter raised the allegation.

The Equal Protection Clause claims that a person can only raise a violation of the 14th Amendment if he has been victimized, and since Bush was clearly not a Florida voter, his claim should have had no standing. The court cited a 1966 case, *Harper v. Virginia Board of Electors*, which stated that by striking down a poll tax that had prevented poor blacks from voting, it was not discriminating against voters, but rather allowing more to vote. In *Bush v. Gore*, the court cited this case while it subsequently denied tens of thousands of minority voters the right to vote.

The fact that the Supreme Court found merit to use the case in favor of Florida voters who never made the claim, raises questions of whether there were personal agendas behind the justices' ruling. Justice Sandra Day O'Connor had told the *Wall Street Journal* prior to the election that she wished to retire but would not do so with a Democratic president in office, revealing that she had much to lose if Gore won the election. In addition, Justice Antonin Scalia had two sons working on behalf of the Bush team. Bush was awarded the presidency on December 12, but for many people, the presidency was handed to him by a party-biased majority of the Supreme Court.

## THE ENRON COLLAPSE

Corporate crime also mixes with politics in the case of campaign finance. During Bush's election campaign, Kenneth Lay, known affectionately as Kenny Boy to Bush when he was governor of Texas, was

one of Bush's primary campaign fundraisers. The former Chief Executive Officer of Enron donated \$1.75 million to the Bush campaign over the years, and in return, Enron received many presidential perks. Former Enron personnel were appointed to the Bush administration, including Army Secretary Thomas White and U.S. Trade Representative Robert Zoellick.

Thirty-five members of the Bush administration held or had held Enron stock. Vice President Dick Cheney drafted his energy policy after talks with Enron officials, and in addition, Pat Wood, a man strongly supported by Lay, was chosen to be the president's top energy-price regulator.

Unfortunately for Enron, its share price faced a steep decline from January 2001 to January 2002. On August 20 and 21, 2001, Lay sold 93,000 of his personal Enron shares, earning him \$2 million. As Lay sold, he encouraged outside shareholders to continue to buy Enron, insisting that the growing doubts circulating about the company were untrue. On December 2, 2001, Enron applied for bankruptcy. The Federal Bureau of Investigation entered Enron headquarters in January 2002 after it was discovered that Enron was shredding documents. The Enron collapse was the biggest corporate collapse in the history of the United States at the time.

As Bush prepared for his State of the Union address, it became clear that he and his administration had deep ties to Enron. However, not even this close relationship could save Lay and Enron from investigation, and the president (wisely, some would say) made no sign to help Lay or Enron. Rather, the president was trying to distance himself as far as he could from the scandal. The real losers of the Enron collapse were the outside stockholders, those who had no idea that the company was faltering and were intentionally and deliberately misled. These stockholders lost life savings and many lost their jobs as Enron went bankrupt.

While Enron's donations undoubtedly bought the company many advantages with the Bush administration, perhaps its greatest asset was the fact that members of the Bush administration, including the president himself, remained silent during the fatal collapse of the company, meaning the certain demise for the outside shareholders. The Bush administration admitted on January 17, 2002, that it had conducted a review of Enron's problems in October 2001, while the company was heading quickly toward bankruptcy.

## SEE ALSO

Enron; bank fraud; pension fraud; securities fraud; campaign finance.

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## Butcher brothers

In 1976, Jacob F. "Jake" Butcher and his younger brother Cecil Hilque "C. H. Jr." Butcher, Jr., created Tennessee and Kentucky banking operations worth almost \$1 billion. Nine years later these high-living bankers were incarcerated following federal convictions related to various fraudulent practices in their banking empire.

With the exception of one credit life company, the brothers' holdings were held separately. They did fund their purchases similarly: When they could, the Butcher brothers financed their bank acquisitions by getting the seller to finance the purchase. When that was not possible, they borrowed the money from a larger bank. At their peak, the two brothers owned or controlled almost 40 banks with approximately \$3 billion in assets.

The Butchers' banking empire began to crumble January 19, 1983 with a cease-and-desist order from the Federal Deposit Insurance Corporation (FDIC) against Jake's United American Bank (UAB) of Knoxville, Tennessee. That order and another the following month accused the bank of issuing false and misleading information regarding the bank's condition, and directed it to correct its 1982 financial statements and the information the bank provided.

The bank was declared to be insolvent on February 14, sold to the state's largest bank holding company, and reopened the following day as First Tennessee Bank of Knoxville. The failure of UAB Knoxville was the nation's third-largest.

Several of C. H. Jr.'s banks faced runs by depositors after the February close and sale of UAB, and his finance company, Southern Industrial Banking Corporation, filed for bankruptcy in March. Following regulatory pressure to support his banks, April 1983 brought the sale of most of C. H. Jr.'s banking interests. In May, the FDIC arranged for the sale of five more of the Butcher Tennessee banks, creating the single biggest day of bank closings since the Depression. Between February 14 and August 26, 1983, nine banks owned by the Butcher family failed and 11 others in which they had interest or association were sold or merged.

Banks owned or controlled by the Butchers, or their friends, made loans to individuals and other banks which exceeded the amounts allowed by law, as well as by good business standards. In some cases, collateral offered was over-stated in value, in one case by 100 times the purchase price of the collateral. The Butchers and their associates also set up companies under different names, and took out loans from Tennessee and Kentucky banks without telling the bank officers that the same people were affiliated with these companies and would be getting the proceeds from more than one loan.

Butcher-owned or -managed banks were found to be making loans without adequate documentation, collateral, or consideration of the credit-worthiness of the borrower. Excessive loans were also made to the Butchers, bank directors, and their associates and friends. The banks then traded the loans back and forth among other banks controlled by Jake and C. H. Jr. to make it harder for bank examiners to discover the hidden accounting problems.

Along with the fact that loans were shuffled from one bank to another, state regulators had difficulty discovering irregularities and fraud for other reasons: The geographic area covered by these banks was included in two FDIC regions and three Federal Reserve Districts. Short staffing was another problem; in 1983 Kentucky only had 33 examiners responsible for 263 state-chartered banks, and Tennessee had 38 examiners for 281 state-chartered banks.

Losses from the failures of United American Bank of Knoxville and other Butcher banks cost the FDIC approximately \$1.1 billion, perhaps the most costly bank collapse in the nation's history to date. The FDIC reimburses depository customers up to \$100,000 each, but does not reimburse people

for losses on their shares. The Butcher brothers were bank shareholders.

#### THE BUTCHER CONVICTIONS

In June 1983, the FDIC and two banks filed a bankruptcy petition against Jake who had been an unsuccessful candidate for governor of Tennessee in 1974 and 1978, and chairman of the 1982 World's Fair in Knoxville. Jake was indicted on several charges in 1984, and on April 22, 1985, in a plea agreement, Jake pleaded guilty to 20 of 92 counts of bank fraud, and four of nine counts of conspiracy. He also pleaded guilty to tax charges related to failing to report \$38.5 million in income. In June and July 1985, Jake was sentenced to five 20-year prison sentences, to be served concurrently, on the fraud and conspiracy charges. The sentence ensured he would be required to serve at least one-third of the sentence before being eligible for parole. He was also sentenced to 14 years imprisonment for tax evasion. If convicted of all charges Jake could have been sentenced to penalties of up to 501 years imprisonment and \$436,000. He was paroled in 1992.

By June 1983, a lawsuit was filed to force C. H. Jr. into involuntary bankruptcy because of \$13.4 million in overdue loans to three banks and the FDIC. In August 1986, he was found innocent of 25 counts of fraud in conjunction with the failure of his Southern Industrial Banking Corporation. If convicted on all of these charges, he could have been sentenced to 115 years imprisonment and

finest of \$25,000. In April 1987, C. H. Jr. pleaded guilty to two counts of conspiracy, four counts of bankruptcy fraud, and four counts of bank fraud. C. H. Jr. served 6 years of a 20-year sentence. He was paroled in 1993 and five years later placed on probation which was to end in 2003. In 1999, C. H. Jr. paid off his \$319,019 criminal fine. He died April 30, 2002.

#### SEE ALSO

bank fraud; United American Bank; savings and loan fraud; property fraud.

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# C

## campaign finance

THE MOTTO of the animals in George Orwell's *Animal Farm* is "All animals are equal, but some animals are more equal than others." The irony, of course, stems from the fact that the animals started out trying to establish a completely equal system, but they failed miserably. The same can be said of campaign finance.

Reforms are generally aimed at the equality of voters, but the reality of campaign finance is that huge corporations and high-spending individual contributors have always been "more equal" than other voters. In addition to voter equality, campaign finance laws have been directed at stemming the rise of corruption. As a rule, efforts at campaign finance, like the efforts of George Orwell's animals, have failed miserably. After each attempt at reform, a new loophole seems to open up, and the result is almost always further inequality of voters and new methods of political corruption.

Elected officials are almost always campaigning. Terms of office at the national level were staggered by the framers who wrote the U.S. Constitution in an effort to guarantee stability. Even though the president does not have to face re-election for four years, campaign strategy and finance for the next election start almost immediately after an election, since both the president's party and the opposition

party must plan for the off-year elections that are only two years away. Every two years, the entire House of Representatives must face re-election, as well as one-third of the Senate, and many states hold elections at the same time. As soon as the off-year elections are over, the focus returns to the next presidential election two years later when, in addition to the president and vice president, all members of the House and another one-third of the Senate will be elected, and the cycle of campaign financing begins again. As a result, politicians are always conscious of the next election and must be constantly aware of how much money might be needed to finance the campaign. It has become a fact of life in contemporary American politics that the candidate who spends the most money generally wins an election.

## ONE PERSON, ONE VOTE

The concept of one-person-one-vote was guaranteed by the Supreme Court in three separate cases in the 1960s: *Baker v. Carr*, 369 U.S. 186 (1962), which applied the concept of one-person-one-vote to state house seats; *Reynolds v. Sims*, 377 U.S. 533 (1964), which applied the concept to state senate seats; and *Wesberry v. Sanders*, 376 U.S. 1 (1964), which applied the concept to seats in the U.S. House of Representatives. The whole concept of

one-person-one-vote has serious implications for campaign finance because there is little doubt that individuals and groups that contribute large amounts to political candidates have historically sought some sort of return on their investment.

Abraham Lincoln defined democracy as “government by the people, for the people, and of the people.” If Lincoln’s interpretation is correct, then a basic concept of democracy is the right of the American voter to select candidates based on free access to information. Unfortunately, there is no requirement that the information be truthful. Throughout history, the American voter has been deluged with campaign rhetoric that paints the other candidate as incompetent, irresponsible, or corrupt. Since television entered the scene in the early 1950s, political campaigns have become increasingly sophisticated and more manipulative.

Political candidates are “packaged” in the same way that products are, and with the same intention: to convince the consumer (voter) how much better off she is with the product (candidate) in the ad. Ronald Reagan, for instance, hired Madison Avenue advertisers to package his 1980 campaign against the Democratic incumbent, Jimmy Carter. Candidates are usually presented to the public either through spot ads of up to 60 seconds or through short issue messages, which may last as long as five minutes. Television advertising is expensive, making up the largest part of budgets for political candidates. Since these costs rise with every election, candidates’ teams are always on the lookout for ways to make more money. This is particularly true when elections are hotly contested. For example, the 1996 Georgia election in which Speaker of the House Newt Gingrich was fighting for his political life cost a total of \$56,852,466.

## HISTORY OF CAMPAIGN FINANCE

The first American campaign finance law was passed even before the American Revolution when the Virginia House of Burgesses prohibited politicians from winning votes through bribery. It was common practice in the early days of American history for politicians to pay voters or to grant them favors in exchange for votes. The party machines were notorious for such practices.

In 1867, Congress passed a naval appropriations bill that banned politicians from pressuring workers in navy shipyards to contribute to political cam-

paigns. Thirteen years later, the Civil Service Reform Act of 1883 brought employees of the Civil Service into the protected class, exempting them from political pressure. By the beginning of the 20th century, reformers had recognized the fact that allowing wealthy donors to give unlimited contributions paved the way for political corruption and inequality of votes. President Teddy Roosevelt was one of the first to call for a ban on this activity.

Congress passed the first campaign finance laws of the 20th century in 1907, 1911, and 1915. Although a weak campaign finance bill was later passed, which placed a ceiling of \$5,000 on individual campaign contributions, restrictions were rarely enforced. The status quo generally prevailed for the next three decades. By the 1960s, campaign finance was rife with political corruption and pressure politics, and campaign contributions were being received from a variety of questionable sources. Political scientists and various reformers insisted that major campaign finance reform was needed to protect the democratic system, and the next decade widened the demand to such a point that Congress and state legislatures were forced to act.

In 1970, a limited campaign finance law passed Congress, but President Richard Nixon vetoed the bill. He blamed Congress for not going far enough in reforming current laws and promised support if the bill were expanded to more accurately meet the goals of campaign finance reform. The following year, Common Cause, an active citizens’ lobby, brought suit against both the Democratic and Republican parties, arguing that the Federal Campaign Practices Act of 1925 was being ignored. In response, Congress recognized the need for immediate action, and the result of that was the 1971 passage of the first Federal Election Campaign Act (FECA).

## REPERCUSSIONS OF FECA

Nixon was seeking re-election in April 1972 when FECA was set to take effect. As part of his re-election efforts, Nixon had established the Committee to Re-elect the President (CREEP) under the leadership of Maurice Stans and Herbert Kalmbach. At one point, CREEP was reportedly raking in amounts as large as \$100,000 per day. Some of this money was coming from questionable sources such as donors with less than sterling reputations and foreign donors who would not, or should not be

identified. CREEP also used the grace period before FECA took effect to pressure large corporations into substantial donations.

No one at CREEP paid any attention to existing campaign law that required disclosure of large donations. Common Cause, however, had not forgotten, and in September the group sued CREEP under the Corrupt Practices Act for failure to report campaign contributions before FECA took effect on April 7. Unfortunately for Nixon and CREEP, they were forced to make their secret list of donors public. Matters were further complicated for Nixon and his re-election team by the growing scandal concerning the break-in of the Democratic National Committee office at the Watergate Hotel on June 17. In the two years that followed, the Watergate investigation revealed the ugly secrets of CREEP, including money-laundering schemes and a host of other illegal practices.

On August 9, 1974, Nixon became the first president in the history of the United States to resign from office. In the meantime, some members of his re-election team and a number of his closest political advisors had been sent to prison for various abuses of power or on other charges. Congress reacted to the abuses of the Watergate scandal by regaining control of the legislative process and went through a period of refusing to follow presidential proposals for Congressional action. Subsequent versions of FECA strengthened and amended the law to further encourage open political competition, which involved the public more directly in financing political campaigns, and restricted the ability of large campaign donors to demand favors.

## FEDERAL ELECTION CAMPAIGN ACT

The main provisions of FECA established requirements for reporting the names of contributors and the amounts of donations and campaign expenses, restricted the amounts of donations, created a method of public funding, and established an oversight board. Before FECA was set to take effect on April 7, 1972, federal politicians scurried to build huge campaign chests before they were required to meet FECA restrictions on donations and to release campaign finance information to the public.

*Disclosure.* FECA stipulates that political parties and Political Action Committees (PACs) must provide periodic reports of campaign contributions and expenditures. All individual contributions of

more than \$200 in a calendar year must be reported, as well as all expenditures of more than \$200 a year.

*Contribution restrictions.* FECA places a \$1,000 limit per candidate per election for each adult. Primaries and general elections are considered separate elections. Individuals may give up to \$5,000 per election to a PAC or to state party committees. FECA restricts contributions to national party committees to \$20,000 per election. Corporations, labor unions, federal government contractors, and foreign nationals are prohibited from contributing to federal campaigns.

No individual can contribute more than \$100 in cash to any federal candidate for political office, and no one can contribute campaign money in someone else's name. "Soft money" contributions by individuals, groups, unions, Political Action Committees (PACs), and corporations to the party committees, which bypass the restrictions of FECA, are unlimited. Individual donors and PACs may spend as much of their own money as they choose on "issue advocacy" to promote political candidates. The national party committees also have no limits on expenditures of "soft money."

"Soft money." This has proved to be one of the most profitable and effective ways for political parties and PACs to bypass FECA restrictions. "Soft money," as opposed to "hard money," is raised from sources not restricted by the provisions of FECA. For example, "soft money" may be generated to finance issue advertising for a candidate or to promote voter registration drives by a political party.

Before 1992, "soft money" bypassed both the disclosure and restriction requirements of FECA. In the first year of reporting, Democrats documented \$36.2 million in "soft money," and Republicans documented \$49.7 million in similar funds. By the 2000 election, amounts collected from "soft money" had grown to \$243.1 million for the Democrats and \$224.1 million for the Republicans.

*Public funding.* FECA was created to provide presidential candidates with public funds for campaigning that would curtail the need for contributions from those seeking political favors. Public funding is generated through the tax check-off on individual income tax returns.

Initially, the check-off amount was \$1, but it was subsequently raised to \$3. Presidential candidates may receive public funds only if they choose not to spend their own money for campaigning, and

they are restricted to FECA guidelines if they do accept funding. Public funds are used to match individual contributions of up to \$250, but they cannot be used to match donations from either PACs or political parties.

To qualify for matching funds, a presidential candidate must prove viability by raising over \$5,000 in each of 20 different states. The total amount of matching funds is adjusted for inflation rates for each election. For example, in 1996, \$30.91 million was allotted for matching funds in primary elections. General Election Grants were designed to cover all campaign expenses and no additional campaign funds were allowed.

The adjusted rate for 1996 was \$61.82 million. In order to qualify for General Election Grants, a candidate must have received at least 5 percent of the total primary vote. In addition to campaign and general election funds, each major political party is given funding for political conventions. In 1996, the Democratic and Republican parties each received \$12.36 million to finance their political conventions.

*The Federal Election Commission (FEC).* The FEC was created by Congress to police campaign finance, but legislators gave FEC members little authority or ammunition to carry out their role. To begin with, Congress failed to grant sufficient appropriations for FEC's oversight activities. Additionally, the six-member group, made up of three Democratic and three Republicans, is composed of party supporters who may have little expertise in campaign finance matters. Because decisions may break down on party lines, there is not way to end a stalemate. And because the six members rotate the position of chair in one-year terms, there is a lack of consistency in what the FEC does.

Oversight is further limited because Congress chose not to give the FEC the right to make random audits. Instead, the FEC depends on reports from the candidates to determine compliance. Non-compliance is usually punished by levying fines. In cases of inadvertent violations, the FEC is limited to levying civil penalties of no more than \$5,500 or the amount involved in the violation. If the violation occurred "knowingly" and "willfully," the amount may be doubled to \$11,000 or twice the amount of the contribution. When violations are deemed criminal, the violator may be fined no more than \$25,000 or 300 percent of the contribution and may be imprisoned for up to one year or both. Political

candidates and their election teams have proven adept at finding ways to circumvent the restrictions of FECA. The wealthy, interest groups, big corporations, and labor unions have become particularly skillful at obeying the letter of the FECA law without restricting their contributions.

## SUPREME COURT DECISIONS

The 1st Amendment of the Constitution guarantees the right for Americans to freely express opinions, and supporting a particular candidate for political office is an inherent right of democracy. In 1976, the Supreme Court heard a challenge to the 1974 version of FECA; and while the Supreme Court has been reluctant to uphold restrictions on campaign contributions, it did acknowledge in *Buckley v. Valeo*, 424 U.S. 1 (1976), that corruption, or even the appearance of corruption, may call for some oversight and restrictions on campaign contributions.

The *Buckley* decision determined that FECA restricted free speech and removed Congressional elections from FECA restrictions. It also overturned the limits on total campaign spending and on the amount that individual candidates can spend of their own money on their own political campaigns. *California Medical Association v. FEC*, 453 U.S. 182 (1981), upheld limiting the contributions of PACs to \$5,000. In *FEC v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986), the Court decided that Massachusetts could not ban corporate contributions to independent groups who were involved in supporting specific political candidates because of their stands on issues such as abortion or gun control.

On the other hand, in *Austin v. Michigan State Chamber of Commerce*, 494 U.S. 652 (1990), the court upheld Michigan's ban on corporate expenditures that prevented general treasury funds of the chamber of commerce from being used to fund political candidates. The chamber of commerce placed no restrictions on separate funds being used for these purposes. In 1991, the court overturned the conviction of a state politician who had repaid a political contribution by introducing a bill in the West Virginia legislature, in *McCormick v. United States*, 500 U.S. 257 (1991). In 1995, in *McIntyre v. Ohio Elections Commission*, 514 U.S. 334 (1995), the Supreme Court upheld the distribution of anonymous political advertising, deciding that to demand

disclosure was to engage in overbreadth, which simply means that legislators go so far in making something illegal that they trespass on legal rights. A 2000 decision by the court indicated that they would continue to uphold the provisions of *Buckley* and to frown on strict restrictions on campaign contributions. *Nixon, et al., v. Shrink Missouri Government PAC*, 528 U.S. 377 (2000), overturned a Missouri law that limited political contributions to no more than \$1,075. The Supreme Court contended that the \$1,000 limit, acceptable under *Buckley* in 1976, may not have been acceptable in 2000 and agreed with the candidate that the low contribution limit placed by Missouri interfered with his ability to effective campaign for political office.

#### POLITICAL ACTION COMMITTEES (PACS)

Early attempts at campaign finance reform neglected to limit campaign contributions to PACs. The number of PACs has grown astronomically in the last three decades. In 1974, there were 608 registered PACs in the United States. Ten years later that number had grown to 4,009. A Political Action Committee is generally created by a corporation, like Coca Cola Bottling Company, or by an industry, such as the beer industry, but it may also be created by individuals who band together. A PAC cannot be created to support a single candidate for office. In 1996, 64 percent of PACs were business oriented, 8 percent were labor-connected, and 28 percent were independent.

Since historically business tends to be more supportive of the Republican Party and labor more supportive of the Democratic Party, it is easy to see that Republicans have been more likely to receive the lion's share of PAC contributions. Subsequent laws on PACS allowed parent organizations to take control of administration and fundraising expenses and to determine decisions on distribution of PAC funds. A PAC can contribute up to five times as much as an individual can give to an individual candidate or a party, and there is no limit on the total amount that can be given to all candidates or to political parties. A number of PACs contribute to both Democratic and Republican candidates. Under current FECA restrictions, PACs may contribute up to \$5,000 per candidate per election.

Incumbents generally have several advantages over their challengers. In campaign finance, this means that incumbents do not have to work as hard

to build campaign funds. That is not to say, of course, that incumbents always need more money. When incumbents occupy what is known as "safe seats," little financial outlay is necessary to win reelection. An incumbent may, however, outspend the challenger by a large margin in tight races.

A challenger often has to expend extra effort to convince donors that her campaign is viable and that campaign contributions will not be wasted. On the average, in the Congressional elections of 1996, 1998, and 2000, winners outspent losers by 2.5 to 3 times. In 95 percent of all House races, the biggest spender won. For example, in 1996, the average winner spent \$650,000 while the average outlay for losers was only \$211,000. The Missouri race between Democrat Richard Gephardt and Republican Deborah Wheelahan in that same year further illustrates the vast differences between incumbent and challenger spending.

The campaign outlay for Gephardt was \$2,609,500, while his opponent spent only \$48,873. One reason that winners raise more money is that PACs are more likely to contribute to their campaigns. For example, in the 1997-99 election cycle, 78 percent of PAC funds were directed toward winners, and only 10 percent toward challengers. The other 12 percent of PAC funds was given to candidates in open seats where neither candidate was an incumbent.

#### LOBBYISTS AND INTEREST GROUPS

Lobbying is integral to the pluralistic American system. In theory, pluralism dictates that opposing interests check each other by preventing any one individual or group from gaining too much power. In practice, lobbying Congress is a big business because members of Congress are more likely to be influenced by interest groups than by individual voters.

Special interest groups that lobby legislators spend millions of dollars in campaign contributions in each election. Interest groups tend to give to political candidates who are likely to support their views or to the candidate who is most likely to win. After all, only a successful candidate will be in a position to repay contributors with political favors. For example, the National Rifle Association contributes millions to the Republican Party to persuade the president, Congress, and state legislators not to enact gun control legislation. Sometimes

contributors give to both Democratic and Republican candidates to cover their bases and to have some influence with whichever party wins.

As long as campaign finance reform is not a major priority with the voters, Congress has little incentive to enact effective reform. A CBS/*New York Times* poll in April 1997, for instance, revealed that 75 percent of those questioned were convinced that Congress was more responsive to major campaign contributors than to their constituents. Yet, only 22 percent of the respondents even knew that federal law places limits on individual contributions to political candidates. Nor were respondents willing to finance political campaigns with taxes. An overwhelming 78 percent vetoed the idea of totally financing political campaigns with tax-generated funds.

The American media has named itself the watchdog of campaign finance excesses and abuses. Journalists are quick to notice when candidates spend money unnecessarily or when contributions are unusually large or when they come from questionable sources. For example, in the midst of its high-profile scandal, the Enron Corporation contributed millions of dollars to George W. Bush's presidential campaign. Even the most open-minded observer recognized that funds that should have been directed toward retirement funds for Enron employees were being used in an effort to gain political favors.

The move toward major campaign finance reform accelerated in the states in the early 1970s. Once Colorado and Washington had begun the trend with innovative reforms, the other 48 states followed suit. The money spent on state elections, as well as on national elections, has escalated astronomically, and states have passed their own campaign finance laws. Election costs in gubernatorial elections increased 44 percent from the 1977 to 1992. As a result of spiraling costs and a number of campaign finance scandals, most states have mandated increased reporting of contributors and amounts given and have become more restrictive in maximum contribution limits.

In 1980, only nine states placed a ceiling of \$1,000 on campaign limits. By 1996, six more states had followed suit. Out of the 28 states that had no contribution limits in 1980, only 15 states continued this practice into 1996. Californians traditionally spend the most on both state and national elections, and the state often serves as an innovative

model for other states in legislative efforts. If California set the standard for effective campaign finance reform, other states would surely follow. Various states continue to tighten restrictions on campaign financing.

## PROS AND CONS OF REFORM

Those who oppose any kind of campaign finance reform often argue that restrictions on voters is undemocratic. Many FECA opponents suggest that financial restrictions interfere with free enterprise. Opponents generally accept the pluralist argument that the government has no need to place artificial limits on political actions because opposing groups provide inherent checks. There is also a tendency among those who oppose campaign finance reform to blame the Supreme Court for not clarifying its definition of corruption so that restrictions would not apply to those who do not fall under the specified definition.

Unlike opponents of campaign finance reform, most scholars of campaign finance reform agree that excesses and abuses of campaign finance would be reduced if the need for enormous television expenses were removed. One way to do this would be to allot candidates free airtime on an equal basis. As early as 1969, the Twentieth Century Fund was calling for "voters' time" that would give all major candidates six 30-minute slots in the time immediately preceding an election to "sell" themselves to the voters in simultaneous broadcasts that would be paid for by the federal government at a reduced rate of 50 percent.

A major study by the Association of the Bar of the City of New York's Commission on Campaign Finance Reform suggested that campaign finance reform would be more effective if public funding were extended to include Congressional candidates, if campaign contribution restrictions were more realistic, if controls on "soft money" were enacted, and if the FEC were restructured and given more authority. Critics of the FEC have suggested that even distribution of votes between the Democratic and Republican promotes gridlock, and they call for the addition of an independent member.

They argue that enforcement procedures should be simplified by giving the FEC more authority and expediting court procedures. Reformers contend that the FEC should also be able to conduct random audits rather than depending entirely on re-

porting by the candidates. They also believe that whenever a violation is uncovered, it should be dealt with immediately. For example, the public interest was not served when former President George H.W. Bush reportedly received notification of a campaign finance violation months after he had lost the election to Bill Clinton in 1992. Major reform of the FEC seems unlikely, however, because in 2003, the Democrats removed Scott Thomas, the active Democratic chair of the FEC, because he was attempting to stifle campaign finance abuses.

Most suggested campaign finance reform is designed to limit the loopholes that led to the proliferation of "soft money" over the past three decades. There is also a move toward government regulation of "issue advertising" that promotes a particular candidate while attacking his opponent in less than truthful terms. Placing legislative restrictions on "soft money" has been complicated by the Supreme Court's position on campaign contributions as free speech because it is difficult to identify the exact point where free speech ends and legitimate restrictions begin.

In 1997, in a joint resolution (S.J. Res 18), members of the Senate attempted to amend the Constitution to mandate Congressional and state authority to establish contribution limits. The resolution failed 38 to 61. Democrats split 34 for and 14 against the constitutional amendment, while only four Republicans voted for it. A number of bills aimed at tightening earlier versions of FECA were remanded to the House Committee on House Administration in 2003. Bills in the House of Representatives included H.R. 156, which would require those who conduct telephone surveys on federal campaigns to identify the individual or group who sponsored the poll to the respondent and to disclose the total cost of the poll and the funding sources for the poll to the FEC.

It would also mandate that the conductors of the poll furnish a copy of the survey to FEC, along with a report on the total number of households surveyed. H.R. 681 would extend the Bipartisan Campaign Finance Reform Act of 2002 (also known as the McCain-Feingold Act) to prevent committees that received personal loans from a federal candidate from repaying the loan while the candidate is in office. H.R. 797 would amend the 1971 version of FECA to ensure that no campaign funds could be used to pay salaries of candidates or their family members. H.R. 1878 would amend FECA to

provide public funding for elections for members of the House of Representatives. H.R. 2529 would amend FECA to limit out-of-state political contributions to no more than 25 percent of total contributions. This proposed action is in response to practices that allow national political parties or groups to channel funds into a state to support a candidate who is in danger of losing a close race, or to defeat a candidate who is considered damaging to their views on certain issues. H.R. 2529 would also institute expanded disclosure requirements. H.R. 2709 would replace the Federal Election Commission with the Federal Election Administration and make major revisions in the operation of the new group. A similar Senate bill, S. 1388, was referred to the Senate Committee on Rules and Administration.

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corruption; government contract fraud; Nixon, Richard; Bush, George W.; Enron Corporation.

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## Canada

ALTHOUGH VIOLENT crime pervades the mass media and dominates public perception about the crime problem in Canada, white-collar and corporate crimes actually do more harm, cost more money, and ruin more lives. The Canadian economic history is, in fact, filled with white-collar and corporate crimes and illegalities.

Federal statistics show an annual increase of seven percent in the incidence of white-collar and corporate crimes. A Statistics Canada report in the early 1980s found the number of workplace deaths attributed to unsafe or illegal working conditions to be equivalent to the number of street homicides. This does not include "lingering deaths" resulting from exposure to "hazardous workplace pollutants." According to some studies, Canadians pay increased taxes and prices for consumer goods amounting to as much as \$20 billion a year as a result of white-collar crime.

Many types of white-collar crime can be found in the Canadian Criminal Code. Provincially created white-collar offense codes, though not criminal law in the strict sense, are also enforced through the traditional criminal justice system. Police and prosecutors at the federal, provincial, and municipal levels bear the primary responsibility for taking action against most individual white-collar criminals.

The difficulty of the enforcement effort to control white-collar crime by the criminal justice system is notable, partly because the enforcement

agencies in Canada receive relatively few complaints from victims of such crimes.

## PROSECUTION AND REGULATION

The criminal justice system, in general, lacks sufficient resources to detect and prosecute white-collar crimes. Moreover, the defendants in white-collar cases tend to put up a much stronger legal defense, since they usually have far more financial resources to hire experienced attorneys. An alternative means of regulating white-collar crime in Canada is for the state to impose certain duties of care on people, and to allow the plaintiff to seek damages from the defendant for the wrongdoing. In general, white-collar and corporate crimes seem to be easily condoned by the criminal justice system and the general public, compared to street crimes.

Corporate crimes are usually dealt with outside the criminal law and regulated by separate federal, provincial and municipal laws. Enforcement is handled by special government departments and bodies through a regulatory system focused on mediation and compensation rather than on prosecution and punishment. For example, the Canadian provinces have introduced workers' compensation acts and regulations governing occupational health and safety that create systems of workplace safety standards and inspection.

The best-known example of legislative efforts against corporate crime is the federal Competition Act (formerly the Combines Investigation Act), which prohibits various forms of potentially anti-competitive acts. These include unfair margin squeezing, freight equalization to impede competition, misleading advertising, the use of fighting brands to eliminate a competitor, conspiracies to fix prices, and other corporate crimes. Responsibility for the enforcement of the Competition Act is divided among several authorities: Parliament which passes the legislation; the Director of Investigation and Research (DIR) under the Competition Act who heads the Competition Bureau and investigates possible violations; the Department of Justice (DOJ) which takes cases before the courts or Tribunal; and the adjudicators who determine if a violation has occurred and, if so, what penalty or remedy is appropriate.

The average fine per firm increased over seven times in real terms between the five-year periods 1986–90 and 1991–95. The largest fine per firm rose





*The city of Vancouver, on Canada's Pacific coast, is a modern metropolis that exemplifies Canada's business growth. Along with economic growth, however, Canada has seen huge increases in white-collar and corporate crime.*

from \$1 million in 1990 to \$2.5 million in 1995. These larger fines, however, do not necessarily mean that all the economic gain from the conspiracy was eliminated.

Even taking into account all the costs they incurred, the convicted firms may well have profited from violating the conspiracy provisions. This raises the question whether these enforcement actions achieve specific and general deterrence as they are supposed to do. Furthermore, the Competition Bureau's budget has declined in real terms in recent years. The record indicates that the average number of criminal prosecutions (excluding misleading advertising cases) rose from an average of five per year in the period 1966–70 to 16 in the period 1981–85 and then fell to an average of 5.8 per year in the period 1991–95. The biggest drop in the number of prosecutions has occurred in price maintenance and misleading advertising cases. The speeches of bureau officials indicate that, due to budget cuts, cases that in the past would have resulted in a recommendation to prosecute are not being pursued.

#### STATUTE EXAMPLES

Another illustrative example is the provincial securities statutes, which prohibit market participants from engaging in unfair practices, such as stock manipulation and insider trading. The central role of

these statutes is to protect investors in the financial markets by making sure that publicly traded companies play by the rules. There are 13 provincial and territorial securities commissions responsible for enforcing the securities statute in each province. But the regulatory agencies' power lies more in persuasion than in punishment.

The commissions can force companies to comply with securities rules, fine them when they don't, and even charge them in civil court (or criminal courts in Ontario and Alberta) with violating the law. Canadian officials have the tools to go after offenders, including broad powers to subpoena documents and witnesses. But they have demonstrated little success in prosecuting securities offenses.

Other examples of white-collar and corporate crime laws include the Canadian Environmental Protection Act (protecting the environment, human life and health from the risks associated with toxic substances); the Food and Drug Act (prohibiting harmful or dangerous cosmetics, device, foods and drugs); the Hazardous Products Act (regulating such products as flammable bedding and consumer chemical products); the Explosives Act (prohibiting various kinds of explosives); and the recently enacted Corruption of Foreign Officials Act (creating offenses relating to the bribing of foreign public officials). Similarly, these laws are not always fully enforced and impose penalties that fail to deter illegal

actions. Many corporations may view the penalties for corporate crime as a mere cost of doing business in Canada.

The ties between the corporate sector and the state have traditionally been even stronger than in some other industrial countries, and the law-reform efforts for stronger legislation, enforcement, and penalties for white-collar and corporate crime have been far more difficult.

#### SEE ALSO

prosecution; consequences of white-collar crime; corruption; bribery; Bre-X; Canadian mining scandals.

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## Canadian mining scandals

THE MINING INDUSTRY in Canada has long been associated with shady business practices and dodgy stock-market deals. Gold mining in particular has always produced a frenzy of speculation. The promise of the "big find" has attracted a disproportionate number of unscrupulous individuals and companies with a get-rich-quick mentality.

Historically, it was individual prospectors who searched for precious metals such as gold. After the growth of mining investment companies in the post-World War II period, however, individuals invested in an exploration and mining company which financed operations by selling shares on the stock market.

Spectacular financial gains are often produced by speculation on the potential value of the mineral deposit before any metal is actually found. Mining companies thus have a great incentive to exaggerate,

misrepresent, or lie about the quantity and value of the metal discovered in order to attract potential investors.

By the 1990s, Canada had become the mine finance capital of the world. Per capita, Canada also had the largest number of stock market scandals in the world, many of which involved the mining industry. It was with the Bre-X scandal of the 1990s, however, that the extent of the problem was truly revealed. Bre-X was founded in 1989 as a tiny mining exploration company.

In 1993, it purchased rights to a potential gold deposit in the Busang area of Indonesia for \$80,000. Subsequently buoyed by the false reports of company geologists, John Felderhof and Michael de Gusman, that the area contained the largest gold deposit ever discovered, the company successfully raised tens of millions in investment dollars from eager investors.

Despite the lack of independent tests to confirm the size of the deposit, Bre-X managed to fool other reputable mining companies, the *Northern Miner*, the most respected trade paper in the industry, prominent investment banks, stock market analysts, and even security regulators for Canadian stock exchanges. As Douglas Goold and Andrew Willis write: "A sky's-the-limit tone would come to flavor any reports on the company right through to the stock's spectacular crash." By 1996, Bre-X stock has risen to a value of \$6 billion and was traded on the prestigious Toronto and NASDAQ stock exchanges.

In mid-1997, the speculative bubble burst. Guzman apparently committed suicide in strange circumstances, leading to a series of independent audits of Bre-X's claims. Soon after, it was confirmed that test samples had been tampered with and that Busang actually contained little gold. Bre-X's stock values dropped to pennies a share. Thousands of investors, many of them modest individuals who used the increasingly popular method of buying stocks from the internet, lost their life savings while numerous high-level company officials, such as company president David Walsh, made tens of millions.

Subsequent investigations of the Bre-X scandal have highlighted the sheer greed of mining industry officials and stock market traders; the lax regulation of stock exchanges; the weakness of national and regional laws against individuals and companies engaged in such fraudulent schemes; and the almost

total lack of protection for consumers who chose to invest in the industry.

#### SEE ALSO

Bre-X; stock fraud; securities fraud; market manipulation; investment trust fraud.

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## capitalism

THE BASIC TENET of capitalism is that the accumulation of wealth for its own sake is a worthwhile economic goal for all individuals. Supporters of capitalism claim that it is a politically neutral system that is only self-managed by the nature of supply and demand.

The model of the economic market under capitalism argues that society will make the most efficient use of our resources and talents if each individual works as hard as she possibly can to meet the demands of all other individuals who decide on their own what they want and need. Thus, the market assumes that we are all each individually motivated by greed. And, as each person continues to strive to meet the needs of others, she will also be motivated to meet her own wants and needs, and thus compete with other capitalists for more profit from meeting the needs or demands of society at large.

This competition allegedly rewards those who meet the demands of others at the lowest price. Proponents of capitalism argue that this motivation to produce in order to meet the needs of others and, thus, make money and meets one's own individual

needs is said to be efficient. This efficiency promotes the acquisition of goods and money. Critics of capitalism point out this model results in unequal outcomes; promoters of the model claim that unequal outcomes are natural or normal. Supporters of this economic system argue that the supply and demand for goods, cut-throat competition, and high levels of income inequality are considered efficient. Capitalism among Western societies, particularly in the United States, flourished through legislation permitting its unfettered growth and support via numerous government subsidies.

## HISTORY OF CAPITALISM

England was the first country in the world to transition from feudalism to capitalism from the 16th to 17th centuries. Capitalism developed out of existing feudal relations because it became profitable for a whole new set of people to contend with the former power and wealth of the old lords of the manor. Richard Lachman argues that the ideological value of private property among the new wealthy grew as peasants in France and England began to organize against the exploitation of the feudal landlords.

These organized peasants won personal freedoms in addition to the right to own land. Subsequently, the new wealthy classes began using the political system to protect and expand their surplus of wealth and land at the expense of the poor. As private property ownership flourished among the former nobility classes, classes of landless laborers remained to be exploited in the developing capitalist economic system. Additionally, a struggle ensued between the monarchy and the new wealthy for power, land, and money.

The first capitalists in England were commercial farmers and ranchers as well as merchants. Thus, national political systems grew from the class struggles between the poor, the political elite, and the new rich. Evidence of this can be seen in the state efforts to make war in order to gain taxable land and thus increase power and income. Furthermore, wars made explicit the need for war materials, which then bolstered the early development of capitalism. Meanwhile, national taxes further impoverished peasants forcing them to sell their land to commercial development projects, increasing the wealth of the bourgeois class and making independent peasants into proletariats or dependent workers. The

use of taxes in France (and in the American colonies) to increase the wealth and power of the state fueled the development of the French and American Revolutions in the late 18th century.

Early colonial America began to seek independence from Britain not because they felt oppressed by a loss of civil or social rights, but because merchants and traders became weary of the economic controls imposed on their profits. Great Britain had imposed a number of merchant restrictions and this was resented in both the northern and the southern colonies. By the 17th century, Boston, Massachusetts, became one of the wealthier cities as the mercantile group gained additional profits from shipping and trade, and conflict grew between the colonies as they competed for trade profits. By the 18th century, Britain continued to tighten its hold on the colonial economy through trade restrictions, the imposition of tariffs on imported goods, and the prohibition of western movement across the land.

These developments also fueled the move toward independence. It was men of property, planters, and merchants who wanted independence and a strong central government to protect their economic and property rights. Thus, the Constitution made property rights the central institution of the new country, resulting in federal government control of commerce between the states, taxes, and trade with other nations. The new American mercantile-based political economy simply replaced the British merchant government. This merchant-style economy, tied to the federal government, fueled America's capitalist development. The Constitution supported the maintenance and reproduction of a financial elite with more money and political influence than most Americans.

#### AMERICAN WHITE-COLLAR CRIMINALS

Before the Revolutionary War however, the first group of richest men in America became rich by providing weapons and other military supplies to the British military in the war against the French during the mid-18th century. The French and Indian War, from 1754 to 1763, made even more men rich on both sides. Both before and during the Revolutionary War, a number of merchants became America's first group of millionaires from the privateering of a variety of other nations' navy and civilian vessels. Once the American Revolution

began, these thefts made those same Americans even richer. Thus, the first white-collar criminals in America were also the first wealthy Americans.

Moreover, early government representatives also committed white-collar crimes. Specifically, the head of the Congress' procurement committee, later superintendent of finance, awarded one-quarter of all government contracts to his own company and stole the rest of his wealth from privateering. More than 3,000 British ships were captured during the American Revolution with cargoes valued at about \$18 million. One of New Hampshire's most successful white-collar criminals, John Langdon, later became the state's governor and a U.S. Senator. John Brown, of Providence, Rhode Island, became a privateer and slave owner, and later his money gave Brown University its name in 1804. By the end of the 18th century, most of America's millionaires were in Massachusetts and most had made their fortunes from privateering, this included the Derbys, Peabodys, Thorndikes, and Cabots. Even John Hancock, was a merchant, smuggler, and privateer.

Government contracts made more people wealthy than privateering during the war and gave rise to the textile industry. Some of the budding capitalists of America were made rich by the federal government contracts.

In 1789, Alexander Hamilton's economic plan included a national banking system and the sale of all the federal government's debt instruments at low prices, making many former privateers wealthier. The federal treasury gave away from \$40 to \$60 million. These government representatives, who valued the financing of the capitalists, became the nations' new economic and political elite. This is contrary to the notion that the market is supposed to operate free of government interference.

In 1791, the first spinning mill operated by waterpower was set up in Pawtucket, Rhode Island. Capitalism had begun and, at first, children were employed, followed by hiring families to weave the yarn in their own homes. By 1795, in cities such as New York and Philadelphia, the proportion of wealth controlled by the top 10 percent of the population grew to 61 percent. Clearly, economic inequality existed since the beginning of capitalist development in the United States.

In 1810, Stephen Girard bought the former United States Bank and then loaned money to the U.S. government during the War of 1812. Girard owned most of the stock in the bank and, between

the money gained on interest from loans to the federal government and ownership of real estate in Pennsylvania, including the oppressive coalfields, he became the richest man in the country by 1831 with \$6.5 million. Coal was important in the new iron industry as it was burned to make iron.

Later, John Jacob Astor became the richest man in the country, primarily from his fur-trading company that also committed white-collar crimes. Specifically, he stole most of his furs from the Indians, or trade them for practically worthless goods. Meanwhile, in the American South most of the richest men were rich from cotton grown and picked by slave labor. In 1826, in other capitalistic developments, the first assembly line was used in the meat-packing industry, where the worker had a fixed location and the product came by the worker on a moving belt. Here, the live animal entered the plant, was slaughtered and each worker performed a specific task on the carcass.

### AMERICA'S FIRST FACTORIES

By the late 19th century, a new wealth had been created, assisted by a government-backed banking and insurance system. In 1886, Francis Cabot Lowell set up the first U.S. factory combing spinning and weaving in the same place. Here, New England farmers' daughters were working in order to earn funds for their fathers or future husbands. These women were America's first sweatshop employees. They worked 72 hours a week, were required to attend church, lived in dormitories at the plant (for which they were charged), and were chaperoned to ensure their moral behavior.

The first blacklists began here as well, when women who protested against work speed-ups or pay cuts were prevented from getting jobs elsewhere through employer discrimination. The women eventually began their own workers' movement aimed at a 10-hour day and, as a result, most were fired and replaced by new Irish immigrants who were willing to work for lower wages because they had no alternative. The Irish were the first permanent labor force in the nation.

This was the beginning of the exploitation of the American working class and the birth of American capitalism that was subsidized by the federal government, leading to the development of a small group of economically wealthy families. Other semi-manufacturing processes grew in the 19th cen-

tury; these included food-processing and flourmills as well as the meat-packing industry.

"By 1860, two-thirds of the Deep South slave-owner's wealth was in slaves and located in the five major cotton states of Alabama, Georgia, Louisiana, Mississippi, and South Carolina. Slaves accounted for about 60 percent of all agricultural wealth," historian Kevin Phillips explains. Half of the South's income belonged to about a thousand families. The federal government refused to compensate the South for their slaves, as plantations owners in the West Indies had been by the British. The U.S. government did not have the funds to accomplish that goal even if it wanted to; thus, the South waged war to keep its slaves and capital.

### CITIES AND MANUFACTURING

Meanwhile, farther North, New York, Philadelphia, Boston, Baltimore, Cincinnati, and St. Louis were fast becoming centers of wealth from water commerce. They also contained America's greatest levels of economic inequality, or the largest gap between the richest and poorest. By 1845, in some of these cities, the top 1 percent controlled from 37 to 40 percent of the wealth. Only in rural areas of the country was republicanism or economic equality still alive. In New York City, by the middle of the 19th century, there were more millionaires than any other urban area in the country (mostly due to owning prime real estate, including houses of prostitution), and this represented one-quarter to one-third of the country's total wealth.

Working-class men began to unite and collectively protest their oppressive treatment and poor wages, although they had little impact as urban poverty continued growing. But by the late 1850s, only about a half-dozen states and 4 percent of the population were employed in manufacturing. New immigrants and freed African-Americans took the jobs of second- and third-generation European Americans, pitting the working class against itself, based upon ethnic or racial lines.

Prior to the Civil War (1861–64), most manufactured items were imported and the major form of profit-making was land acquisition and trading. The smelting of iron during the Civil War increased because of the demand for bullets and canons and the need for railway transportation. The third industry to develop in the country was the gun industry. Eli Whitney and Simeon North redesigned the



*Faneuil Hall in Boston was the site of America's first enterprise: the market. White-collar crime soon followed.*

early process in which a craftsman made each unique gun from start to finish. Now, the parts were made first to a standard pattern and were finally fitted together to make a single weapon. This, of course, was the result of a government contract. In 1813, the process was used to make single-shot pistols and, later Samuel Colt used it to produce the multiple-shot or the six-shooter revolver.

#### FURTHER FUELS OF CAPITALISM

The fuel for the development of early capitalism was characterized by primarily by slavery, imperialism, and colonialism, as Western Europe and the United States exploited the natural resources, humans, and animals in foreign lands in the pursuit of profit and private property. Similar to the manner in which capitalism grew from wars in Europe, in the United States, capitalism's major impetus came



*Railroads were encouraged to expand with land grants provide by the U.S. government.*

in the 1860s as the result of the American Civil War. During the Civil War, the federal government began selling bonds to finance the war. The national debt had increased from \$65 million dollars in 1860 to \$2.6 billion in 1865. Such debts are usually paid for by the losers, while the war winners inevitably become richer. In this case, after the war the North became richer while the South grew poorer.

Prices of wartime supplies rose, benefiting industrialists, while workers' wages lagged behind. Stock market prices fluctuated with the losses and wins of battles but ultimately, as the North began to win the overall war, the stock market prices rose and brokers became rich. The war brought wealth to a number of people, who by the end of the 19th century, included industrialists and merchants J. P.



*Mining, whether above or below ground, was a fuel of capitalistic growth, and led to new corporate crimes.*



*The progress of capitalism in America, and throughout the world, has been relentlessly exploiting new industries for industrial growth. Even in modern electronics factories, worker exploitation continues as well.*

Morgan, John D. Rockefeller, Andrew Carnegie, Jay Gould, Marshall Field, and Philip Armour. The war turned \$10–\$20 million millionaires into millionaires worth \$200 to \$300 million by the 1880s. In 1870, following the loss of the Civil War, the South owned only 12 percent of the nation's wealth, down from 30 percent in 1860. Moreover, a whole new group of Northern industrialists became rich from the production of army weapons, uniforms, and equipment while Southern plantation owners lost slaves, two-fifths of their livestock, and one-half of their farm machinery. Additionally, Northern carpetbagger government officials imposed stiff taxes that further crushed the Southern economy. The South paid for the ensuing economic transformation of the economy, as paper currency was created and income-tax developed, and a new national banking system was begun. Southerners paid \$1.2 million in taxes for the benefit of to the rest of the country after 1865.

### RAILROAD EXPANSION

The federal government provided a great deal of financial support to the railroad companies to build their rail lines and usurp the land of small farmers and ranchers. Related to that expansion was the 1886 Supreme Court case in which the court ruled in *Santa Clara County v. Southern Pacific Railroad* that a corporation is a person and thus has all the same rights and privileges as any other citizen. Thus, as a person it is permissible for the government to finance a company's growth.

Land grants were the major method by which the government supported the growing railroad industry. A land grant provided land for free or at a minimal price to encourage railroad expansion. The railroaders used the wage-ticket system to hire Chinese men without families (so the men would work more hours) to increase profits and build the railways at minimal costs. By 1871, the railway companies had gained about 129 million acres of land and what they didn't use, they sold. They made over \$136 million on land sales while they only paid about \$70 million to construct the railways. In 1834, a group of farmers were the first to refer to capitalists as "robber barons" as the term was originally aimed at the railroad industry.

### REGULATING CAPITALISM

The Sherman Antitrust Act was passed in 1890 allegedly to prevent the development of monopolistic industries that could increase prices on products *ad infinitum*. However, the law actually prohibited anyone or anything from conspiring to restrain trade, including trade unions. Government subsidies to the railroad companies continued through 1890 and included loans of up to \$95 million.

The market and the polity became the best of friends with the profits made by capitalists used to sustain political candidates' campaigns, as well as to produce and maintain the revolving door of corporate executive turned politician, and then back again. An increase in elite capitalist power in the late 18th and early 19th century came when police

forces were organized to protect the wealth of the new industrialists, and to control the poor and working classes through the criminal law.

At the time, the working classes began interfering with capitalist's profits through union protests and work stoppages. Businesses claimed that protesters were violating corporations' due process rights. Similarly, the Federal Bureau of Investigation (FBI) was initially developed in 1908 as an agent of big business. For example, the initial enforcement of the Sherman Antitrust Act was against a labor union charged with restraint of trade.

America became one of the richest nations in the world: By 1900, there were about 4,500 millionaires in the United States compared to only about 10 or so in 1800. Into the 1900s, Americans left farms and became factory employees working 60 to 80 hours per week in unsafe conditions.

## WORKERS' RIGHTS

While relatively few families became rich, conditions for the factory workers in America continued to deteriorate from the late 18th century through the early 20th century with some workers being chained to the floor, and employing children forced to work 12 to 16 hours a day in dangerous conditions. By the early 1900s, the socialist press began calling attention to the horrible conditions in factories and the corrupt political machines that allowed them to exist.

In 1901, the American Socialist Party was formed and began to advocate for workers' education to teach workers how to organize and improve their working conditions. Three types of labor education programs grew in the United States; these included independent labor schools, educational programs associated with unions, and labor studies programs in colleges and universities. By the 1920s, 10,000 workers were participating in worker education programs in over 300 programs across the country. The schools taught employees how to organize strikes and, as a result, workers began collectively organizing.

Subsequently, a strong collective labor movement demanded and won the right to a 40-hour work week, safe working conditions, better pay and benefits, and the prohibition of child labor in the United States. However, by 1954, union membership had leveled off at 39 percent of workers and, by 1999, it had dropped to 10 percent. From 1969

to 1979, strikes involved almost 950,000 workers annually, but from 1987 to 1996, most strikes involved less than a half-million people. Corporations began to break strikes, union members lost wages rather than won increases, and the Democratic Party became less supportive of workers' rights and, like their Republic brethren, became more supportive of corporate America.

Furthermore, a series of court and administrative decisions narrowed the rights of workers while broadening the power of employers. U.S. labor law even allowed corporations to oppose workers' efforts to unionize. For example, while workers are guaranteed the right to strike and they cannot be fired for striking, employers are guaranteed the right to continue to produce goods and thus can hire permanent replacement workers.

However, even though workers' are not as inclined today to organize to protect themselves from industrial exploitation, and corporations wield more workplace power than ever, it appears that district attorneys are moving in a new direction to criminally prosecute corporations responsible for the deaths of workers in dangerous work settings. Prosecutors in 14 states have sent at least 12 corporate managers to jail in the 1990s for the murder of plant or factory workers due to unsafe conditions.

## WORKPLACE DEATH

One of the most infamous cases of workplace exploitation resulted in the death of Stephen Golab at the Film Recovery Plant outside Chicago, Illinois, in 1983. The county medical examiner ruled Golab's death a homicide that was caused by an inadequate safety protection system, which exposed him and other workers to cyanide gas produced in the processing of film at the plant. Moreover, plant managers actually removed the warning labels from the cyanide gas containers at the plant. In 1985, five company executives were indicted for murder and after eight years of court battles, three managers were sentenced to three years in prison for manslaughter. This was the first time that criminal law had been used to convict executives for maintaining dangerous conditions at a workplace.

Since the late 1970s, a growing number of manslaughter and murder charges have been brought against corporations for worker deaths. Traditionally, worker deaths in factories and plants have been handled through the civil court system



where workers and families have received financial compensation in wrongful death suits.

By the 21st century, capitalism made the United States one of the wealthiest countries in the world with the greatest degree of economic inequality. Economic globalization has increased the unregulated strength of American and transnational corporations as well as their wealth.

However, perhaps criminal law may eventually catch up and begin making corporate capitalists accountable for their role in the death of workers, environmental pollution, theft, and financial crimes that have characterized capitalism since the nation's birth.

#### SEE ALSO

American Revolution; American Civil War; ancient mercantile crime; robber barons; unions; government contract fraud; Rockefeller, John D.; Morgan, J. P.

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## Capone, Alphonse (1899–1947)

AL CAPONE IS PERHAPS the most well-known and important figure in the history of organized crime. Also known as Big Al and Scarface, little is known about his youth, other than he grew up in a rough neighborhood and was a member of two youth gangs, the Brooklyn Rippers and the Forty Thieves Juniors. He became part of the notorious

Five Points gang in Manhattan, New York City, and worked in gangster Frankie Yale's Brooklyn speakeasy, the Harvard Inn, as a bouncer and bartender. While working at the inn, Capone received his infamous facial scars and the resulting nickname Scarface when he insulted a patron and was attacked by her brother.

Although Capone ordered dozens of murders and even killed with his own hands, he often treated people fairly and generously. He was equally known for his violent temper and for his strong sense of loyalty and honor. He was the first to open soup kitchens after the 1929 stock market crash and he ordered merchants to give clothes, coal, and food to the needy at his expense. These actions gave his reputation a temporary boost, until the St. Valentine's Day Massacre, Capone's most notorious crime committed February 14, 1929, in which six gangsters and a medical doctor were shot to death.

The news media distributed the death-scene photographs across the nation and the event came to epitomize the lawlessness of the Prohibition era. The massacre occurred at the headquarters of bootlegger "Bugs" Moran's North Side gang, a Capone rival. Because two of Capone's men were dressed as police, the seven victims thought it was a police raid and accordingly, they dropped their guns, putting their hands against the wall.

Using two shotguns and two machine guns, Capone's men fired more than 150 bullets into the victims. In 1930, at the peak of his power, Capone topped Chicago's new list of the 28 worst criminals and became the city's famous Public Enemy Number One.

The popular belief in the 1920s and 1930s was that illegal gambling earnings were not taxable income. However, the 1927 Sullivan ruling claimed that illegal profits were, in fact, taxable. Capone never filed an income-tax return, owned nothing in his own name, and never made a declaration of assets or income. He did all his business through front men so that he was anonymous when it came to income. Financial investigations disclosed a cash-receipts ledger that not only showed the operation's net profits for a gambling house, but also contained Capone's name; it was a record of Capone's income.

Later, Capone's tax lawyer Lawrence Mattingly admitted in a letter to the government that Capone had an income. The ledger, Mattingly's letter, and the coercion of witnesses were the main evidence

used to convict Capone. In October 1931, he was convicted of income-tax evasion and was sentenced to 11 years in prison. While in Alcatraz prison, it was discovered that Capone was suffering from an advanced case of syphilis. He spent the last six years of his life as a recluse in his Florida home. In 1947, Capone died from the aftermath and complications of a stroke.

In the annals of white-collar crime, it has been said that Capone stole as much from the poor as he did from the rich—possibly more through his control of the unions and extortion of small businesses. Indeed, his victims were the working class, and the wealth he displayed came largely out of the pockets of those working people who were tempted into his gambling dens and brothels.

#### SEE ALSO

prosecution; prostitution; racketeering; tax evasion.

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## Caribbean islands

IN MAY 2002, Stanley Works Inc., a Connecticut-based tool-making company, reincorporated in Bermuda, joining the recent list of U.S. firms (Fruit of the Loom, Ingersoll-Rand, and Tyco) "relocating" to escape taxes. The issue was prominently featured in the news and sparked a supposed outcry from politicians who claimed such moves were unpatriotic. Importantly, the issues of tax avoidance, tax evasion, as well as the concerns regarding offshore havens, date back generations. The Caribbean has been the focus in much of this history.

In 1937, President Franklin D. Roosevelt received a report on tax evasion from Treasury Secretary Henry Morgenthau, Jr. Roosevelt forwarded the document to Congress with this message: "Efforts at avoidance and evasion of tax liability [are]

so widespread and so amazing both in their boldness and their ingenuity that further action without delay seems imperative." In response, the 75th Congress created the Joint Committee on Tax Evasion and Avoidance. Morgenthau's report to Roosevelt listed the major and unprecedented devices used to beat the income tax.

Number one was the creation of "foreign personal holding corporations in the Bahamas, Panama, Newfoundland, and other places where taxes are low and corporation laws lax." Morgenthau pointed out the difficulty of gathering information on Bahamian companies (owned by Americans) that are "organized through foreign lawyers, with dummy incorporators and dummy directors, so that the names of the real parties in interest do not appear." In testimony before the Congressional Joint Committee, Morgenthau castigated the many "ingenious lawyers and accountants" who were very well paid to construct immoral methods for their clients to avoid taxes.

In 1961, the Internal Revenue Service's Audit Division prepared a pamphlet for internal use prompted by many signs that schemes for the evasion of taxes were multiplying. These depended largely on the use of controlled foreign corporations, partnerships, or trusts. It was becoming clear that money was being funneled at an increasing pace to offshore countries and newly formed companies in order to avoid domestic taxes. The pamphlet's first example dealt with currency moving through Panama and the Netherlands Antilles. Another illustration featured the Bahamas. In this case, the culprit was quaintly described as "Mr. X, the cunning taxpayer." The Internal Revenue Service (IRS) calculated he owed about \$10 million in taxes and penalties. Interest in this was so new, however, that the IRS felt the need to provide 15 "clues" for agents to alert them to these plots. "Keep watch," agents were informed, for signs such as a license to operate in a foreign country; a domestic corporation borrowing from a foreign corporation; the liquidation of foreign corporations; and the transfer of assets to a foreign corporation.

Thirty years after the first Congressional hearing on tax evasion through the use of off-shore companies, an attorney told IRS Special Agents attempting to untangle his enterprise:

There is nothing more corrupting to our society than a system of taxation. I have no words

strong enough to condemn the society in which we are living in terms of taxation. He (the taxpayer) puts money in a Bahama central trust. Why in the Bahamas? There is no income tax or estate tax in the Bahamas. Why in a trust? A trust is like a corporation, a separate legal entity. This separate entity is a non-resident alien, and a non-resident alien can sell an asset in the United States with no tax. How delightful! Now, if that non-resident alien ties in with a distributing company in the Netherlands Antilles, which can earn interest in the United States without a tax under any circumstances, he has put together a perfect set-up. He takes losses and deductions in the United States and he takes gains and profits abroad, under a tax treaty. Do you think any Congress we have is going to change the laws that allow this? Let's not kid ourselves. With those savings, the rich of this country can afford to buy the entire Senate, if necessary.

Ten years later, the U.S. Senate's Permanent Subcommittee on Investigations (PSI) concluded "that the use of so-called 'secret' offshore facilities has become so pervasive that it challenges basic assumptions regarding the ability of federal and state authorities to enforce the laws." Furthermore, according to the PSI, some Caribbean nations were so corrupted that they essentially offered themselves as crime havens.

Almost all tax havens are characterized by strict rules of bank secrecy and little (if any) taxes. The strict secrecy associated with banks also applies to the activities and ownership of corporations. In addition, there are often no income, profit, capital gains, gift, inheritance, estate or withholding taxes in offshore havens. Although such nations tax imports and some real estate property, this has little effect on those who own or use its many banks or corporations. Thus, for a small initial cost and annual fee, one may own a bank or company that can receive and disburse large sums of money in complete secrecy and without the threat of taxation. These advantages, of course, are available to bank depositors as well.

Even though offshore tax havens may provide legitimate investment opportunities for American citizens wishing to avoid taxes, a practice recognized as lawful by U.S. courts, it is the evasion of taxes by using tax-haven countries that now concerns law enforcement authorities. Douglas J. Workman has

stated, "Tax evasion involves acts intended to misrepresent or to conceal facts in an effort to escape lawful tax liability." Tax havens may be used to hide income or to misrepresent the nature of transactions in order to put the taxpayer in a more favorable position. For tax evaders, offshore havens guarantee that paper trails will be blocked. Though the proximity of places like the Bahamas to the United States was once a key factor in drawing tax evaders and others seeking to hide assets (for example, drug traffickers and money launderers), the pervasive trend toward electronic transfers and other technological advances has diminished geography as the crucial lure.

Offshore havens, including those in the Caribbean, have benefited from the explosion in technologies. This has caused a great deal of grief among U.S. regulators since "banks" may not have vaults or tellers, and do not transact business in the local currency. Offshore banks transfer funds electronically, often using correspondent banks in the United States. Consider the following: The IRS is attempting to investigate MasterCard and American Express card transactions in the United States that were billed to bank accounts in Antigua and Barbuda, the Bahamas, and the Cayman Islands. While Americans can legally move their assets offshore, they are required to notify the IRS of those transactions and to pay taxes on their income worldwide. As one commentator, David Clay Johnston, succinctly stated:

Some Caribbean countries offer an alluring tax haven, however, because they impose no income tax and do not generally cooperate with IRS efforts to track down incomes. But Americans who shelter income offshore face the problem of putting their money to use. That is where a credit card or charge card billed to an account at a Caribbean bank comes in handy, investigators say. Banks in tax refuges issue MasterCards and Visa cards, which can be used anywhere to draw cash and to pay expenses. The bill is then paid automatically from the bank in the tax-haven country, leaving no record of income or spending except for the transaction reports from the networks that MasterCard, Visa and American Express operate. [To facilitate these large credit card transaction, the IRS says some of these banks offer credit cards with \$1 million monthly charge limits.]

The complicated matter of distinguishing between the legal practice of tax avoidance and illegal tax evasion continues to play out in the public and private arenas. For example, American companies have increasingly opted to incorporate in offshore havens, like those in the Caribbean, to sharply lower their tax burden without compromising the benefits of doing business in the United States. Ingersoll-Rand “moved” to Bermuda and its tax burden went from approximately \$40 million to \$27,653 (technically an annual fee rather than a tax). The “move,” however, is nothing of the sort. Rather, it is simply a paper transaction, and does not require anything beyond establishing a mailing address in the haven. Therefore, Ingersoll-Rand will not even establish an office in Bermuda, according to the company’s chief financial officer. He also stated that the firm simply pays a service organization there to accept mail. Significantly, since “companies that move to Bermuda usually keep their main offices in the United States, they continue to have all the security provided by the American government, the legal system and the courts,” Johnston explains.

#### SEE ALSO

tax evasion; offshore entities; offshore bank accounts.

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## Carl Karcher Enterprises

REPORTS OF CONNECTIONS between the Ku Klux Klan and the fast food holding company, best known for hamburger chain Carl’s Jr., are almost certainly urban legends. The misdeeds of Carl Karcher Enterprises (CKE) are not racial but financial, including an insider trading scandal, misvaluation of Arizona acquisitions, and squabbles with co-branding partners.

CKE is named for founder Carl Karcher, who parlayed a hotdog cart into a 2,000-restaurant business with almost \$3 billion in fiscal 2003 sales. In 1984, the first year that CKE offered franchises, the company also expanded from California into Texas, a venture that lost money from the start. An internal company report was available to Carl Karcher and his brother Don, then president of CKE, who gave 14 relatives advance warning of the bad news. A number of family members, though not the Karcher brothers, sold stock in the company before the news became public, avoiding \$310,000 in losses as share value plummeted. All of the Texas restaurants were sold in 1986, when losses reached \$7.1 million.

A Securities and Exchange Commission (SEC) investigation in 1988, at the height of Wall Street’s insider trading scandal, led to Karcher and six relatives agreeing to pay \$664,000 in fines and reparations while admitting no wrongdoing. Half of the amount was to be paid by Carl Karcher to the government, the remainder by the family to damaged shareholders.

The agreement also protected the Karcher family from criminal charges. Civil charges against other family members, including Carl Karcher’s wife, were dropped. CKE accounting director Alvin DeShano settled similar civil charges for about \$25,000. DeShano, the only CKE defendant also

tried on criminal charges, was acquitted of securities fraud, thanks to a defense that portrayed him as too disorganized to commit fraud effectively.

A second failed expansion, this time into Arizona, led to a dispute with hamburger rival Wendy's over unfair business practices. While existing Carl's Jr. stores in Arizona were losing \$5 million a year, CKE bought 10 Wendy's locations from Wendy's franchisee Ronald Brown. Wendy's sued CKE for \$79 million and Brown for \$40 million, arguing that the sale had been made without their permission. The suit was settled for an undisclosed amount in 1990.

Three years later, Carl Karcher's younger brother Frank sued CKE for \$10 million, claiming the company had deceived him about the value of the 12 Carl's Jr. stores that he bought as franchisee in Arizona in 1990, at the time that CKE was converting all 31 of its money-losing Arizona stores to franchise operations. Frank Karcher claimed that the valuation had been based on a formula not disclosed to him, one that inflated sales and profits by relying on deep discounts to drive purchases up.

#### NEAR BANKRUPTCY

By October 1993, Carl Karcher was no longer chairman of CKE. His failed \$106 million proposal to take the company private left him near bankruptcy. He had attempted to oust his board of directors after they rejected his 1989 plan for joint marketing with Mexican fast food chain Green Burrito. Donald E. Doyle, who had replaced Don Karcher as president of CKE, characterized the Green Burrito proposal as good for the Karcher family but not for shareholders. However, Doyle and new chair William Foley II, one of the Orange County businessmen who bailed out Karcher in return for CKE shares, apparently had some interest in the Green Burrito concept.

In January 1995, Green Burrito sued for over \$100 million, charging that CKE, after successfully opening three co-branded Carl's Jr.-Green Burrito restaurants, had stolen their concept for use in its first Carl's Jr.-Picante Grill. Despite the suit, CKE decided, after a failed venture with Mexican fast food chain Taco Bueno, that green burritos were the future. On March 1, 2002, CKE acquired Santa Barbara Restaurant Group, the parent company of both Green Burrito and "fresh Mex" chain La Salsa. Several suits against CKE for improperly de-

priving restaurant managers of overtime pay were filed in 2001 and 2002. As of CKE's annual report, one suit was asking to be certified as a class action under which multiple managers, not specifically named as complainants, could collect damages.

In September 2003, troubled CKE Restaurants announced its return to profitability, citing premium products such as the Six Dollar Burger as critical to the turnaround. Boycotted by gay rights activists and feminists for Carl Karcher's donations to conservative groups, the company hired Playboy founder Hugh Hefner as spokesperson for extensions of the Six Dollar line, with the motto "Because some guys don't want the same thing day after day."

#### SEE ALSO

accounting fraud; insider trading; securities fraud; Securities and Exchange Commission.

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## Carnegie, Andrew (1835–1919)

KNOWN IN HIS time as "King of the Vulcans," Andrew Carnegie is considered to have been one of the most important figures of the Gilded Age, a

time when a thirst for huge profits held sway over conscience. As one of the so-called robber barons, Carnegie vanquished anyone who stood in his way to profit. At a time when the Sherman Antitrust Act of 1890 banned monopolies in the United States, the Carnegie Steel trust, which controlled the supply, fabrication, and distribution of steel, became a model for other American trusts. When Carnegie decided that he had become rich enough, he divested himself of all steel interests and devoted himself to a life of philanthropy. Carnegie gave away approximately \$310 million to various charities and foundations and is most known for the 2,509 Carnegie libraries he established throughout the world.

During the Civil War, Carnegie devoted himself to his own affairs. He was, therefore, astounded when he was drafted into the Union Army in the summer of 1864. Carnegie followed the common practice of hiring a substitute to take up arms for him. This was accomplished by paying a fee to the federal government and calling on the services of a Pittsburgh draft agent, H.M. Butler, who located a recent Irish immigrant, John Lindow, who was willing to join the army in Carnegie's place for the sum of \$850.

To Carnegie, the Civil War was not about preserving the Union or abolishing slavery, it was about business possibilities. He realized that the metals industries would hold an important place in the future of the United States and decided to devote his energies to becoming a wealthy and successful steel magnate. Carnegie started out by buying an iron-bridge plant and followed this up with the purchase of a plant in Philadelphia, Pennsylvania, that made railroad car axles. He manipulated the buy-out of one partner and united the bridge and axle plants into the Union Iron Mills of Pittsburgh. By the mid-1870s, Carnegie was the sole owner of the company and built his own blast furnace to avoid paying locals for their services. In order to ensure sufficient amounts of fuel to run the furnaces, he invested heavily in the coal and coke monopoly of Henry Clay Frick.

A few years earlier Frick, who became instrumental in Carnegie's plans for substantial expansion, had established the Frick Coke Company. Frick had expanded the original 300 acres of coal land and 50 ovens to 450 acres and 150 ovens. Carnegie was impressed with Frick from the beginning and suggested that they become partners. In

1889, Carnegie, Frick, and Charles Schwab established the Carnegie Steel Company. While the partnership proved financially successful, Carnegie was never comfortable with Frick's lack of moral controls. Frick's manipulations set the stage for an 1892 strike at the Homestead plant of Carnegie Steel, and violence broke out, resulting in the deaths of seven workers. Anarchist Alexander Berkman later tried to assassinate Frick. Carnegie attempted to distance himself from Frick who resigned from Carnegie Steel in 1899.

Anyone interested in the steel-making process during the latter half of the 19th century was aware that Henry Bessemer (1813–98) had discovered a process that used blasts of air on molten steel to remove carbon from the steel. The process allowed steel ingots to be transferred directly from the soaking pits to the rollers. The Bessemer process, patented in 1855, cut the amount of time involved in steel-making and drastically improved the quality of the finished product.

Carnegie was quick to realize the importance of the Bessemer process and set out to undercut the production of rails at the Allegheny Bessemer steel plant, which had begun operating in 1888 in Duquesne, Pennsylvania. Carnegie created a pamphlet that was distributed to railroads throughout the United States warning that far from improving the quality of steel, the Bessemer process would produce defective rails. According to Carnegie's highly biased literature, cutting out the second heating of the steel resulted in a lack of "homogeneity" of the structure of the steel produced. The warning seemed to make a lot of sense, and steel manufacturers reacted by rejecting Allegheny Bessemer steel.

Within the next few years, Carnegie proceeded to expand his steel business on an ends-justifies-the-means basis. By July 1, 1892, Carnegie had developed the capability of producing amounts of steel that were equal to half that produced by all the steel mills in Great Britain, at that time the most highly industrialized nation in the world.

#### SEE ALSO

Sherman Antitrust Act; antitrust; robber barons; American Civil War.

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## Carson, Rachel (1907–1964)

RACHEL CARSON was thoroughly educated as a biologist. She obtained her education at the Pennsylvania College for Women, the Marine Biological Laboratory at Woods Hole, Massachusetts, and earned her master's degree in zoology from Johns Hopkins University. She worked for the U.S. Bureau of Fisheries (now Fish and Wildlife) for 17 years.

Through her work as a governmental biologist, she studied fish and wildlife and became very knowledgeable of the environmental impacts of pesticides on animal populations. She was particularly interested in the effects of DDT (dichlorodiphenyltrichloroethane) on the environment. It was through her biological and zoological background and negative reports about DDT and other chlorinated hydrocarbons that she began research and writing her now famous book, *Silent Spring*.

DDT was first used as an insecticide in 1939. It was highly effective in eradicating colonies of mosquitoes and their eggs. DDT was also used during World War II by B-25 bombers that sprayed areas of Pacific islands prior to invasions. It was seen as effective in eliminating malaria in the developed world and drastically reduced its existence elsewhere. The problem with DDT was not its effectiveness, but its indiscriminate effectiveness; it killed everything it came in contact with. This was especially disturbing to Carson, because DDT was killing wildlife and was being used all across the United States, even in residential suburbs to eradicate caterpillars, moths, and beetles that carried diseases.

*Silent Spring* was published in 1962 and created an open debate between the public and the pesticide industry. The book helped to educate the public about the potential dangers and effects of pesticides

on humans and wildlife. The public started to question the use of pesticides, their effect on the environment, and became more critical of the industry and the government. Not everyone was convinced of the veracity of Carson's claims, especially those in the pesticide industry. Many in the industry criticized her accusations and, in a very public manner, discredited her knowledge of science. She did not have a Ph.D. and she was a woman. These two factors alone were used against her. But, soon after the book was published, President John F. Kennedy formed a government group to investigate the dangers of pesticides.

In 1963, the President's Science Advisory Committee announced that the claims made in Carson's *Silent Spring* were indeed correct. Her work helped to promote an environmental movement and was influential in the creation of the Environmental Protection Agency. In 1972, DDT was banned from sale in the United States. Carson died of breast cancer in 1964.

Although her life was cut short, she is credited with helping to start the modern environmental movement. *Silent Spring* has been called one of the most influential books of our time. Former Vice President Al Gore, in the introduction to a 1994 reprint, wrote, "Without this book the environmental movement might have long been delayed or never have developed at all."

### SEE ALSO

Environmental Protection Agency; air pollution; water pollution; pesticides.

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## Carter, James E. (1924–)

IN 1976, JIMMY Carter, a peanut farmer and the former governor of Georgia, became the 39th president of the United States in the wake of the Water-

gate scandal when American trust in government was at an all-time low. In the election, Carter had challenged Republican Gerald Ford (1913–) who had succeeded to the presidency only two years before when Richard Nixon resigned after being identified as an “un-indicted coconspirator” in the Watergate trials. Carter won the election because he was an outsider with a “squeaky-clean” reputation who was not involved in the Washington political scene.

Carter’s Department of Justice (DOJ) was heavily involved in policing government ethics in wake of the Watergate scandal. Griffin Bell, Carter’s first attorney general, restructured DOJ to serve as a neutral legal entity to ensure that the department was not seen as a tool of the president as it had been under Nixon. Bell also worked with the Federal Bureau of Investigation and the Central Intelligence Agency to improve their efforts at catching white-collar criminals and in polishing their agencies’ tarnished images. Both Bell and Benjamin Civiletti who succeeded him were also involved in pursuing other white-collar criminals for crimes such as securities fraud and money laundering.

## THE CARTER PRESIDENCY

In his Inaugural Address in January 1977, Carter promised the American people that his administration would be both competent and compassionate. He set out almost immediately to accomplish competency through reorganizing the executive branch of government and by reducing waste and inefficiency. While both inflation and the deficit did increase dramatically under Carter, he managed to contain unemployment. In a concentrated effort to control inflation Carter introduced an anti-inflation program that included: decreased federal spending, streamlining of the regulatory process, voluntary wage and price standards, and a tax-based incomes program. The press criticized Carter for not making more of an issue of the voluntary wage and price standards with the public by constant hammering about the importance of compliance. A Price Committee and a Pay Advisory Committee were created to bring business and labor into the effort to control inflation, but little was accomplished.

When Carter’s first major effort at anti-inflation failed, he submitted another bill to Congress that contained: selective credit controls, a balanced budget, a gasoline conservation fee, monetary re-

straints, cuts in regulatory costs, and increased emphasis on wage and price controls. One of Carter’s most successful appointments was also aimed at improving the economy. He chose Paul Volker as Chair of the Federal Reserve Board, a position that Volker held for eight years.

While Carter’s outsider status was an asset as a candidate in the 1976 election, it was a drawback as president because he was unwilling to play the political games that are so much a part of being a successful politician. Carter always tried to do the “right thing,” and he honestly believed that members of Congress should do the same without having their egos stroked on a regular basis. As a result, even the Democrats, who controlled both houses of Congress, refused to back many of his proposals. Carter’s efforts at establishing successful liaisons between members of his staff and Congress were also generally unsuccessful. Carter’s dislike of pork barreling, the practice that allows members of Congress to win support for their own pet projects, was another constant source of irritation with Congress.

In addition to executive reorganization and anti-inflationary measures, Carter’s list of domestic proposals included ethics in government laws, welfare reform, hospital cost containment, an emphasis on education, and a new energy resource maximization package. In fact, Carter often made it clear that in the midst of an energy crisis, his major domestic priority was a new energy policy. While he did not achieve all of his goals in this area, Congress did pass energy bills in 1977 and 1980, and the legislature complied with Carter’s request to create a Department of Energy. The energy package was comprised of windfall tax profits, a program to develop synthetic fuels, standby gasoline rationing, a conservation program, and solar energy initiatives. Carter also achieved success in initiatives toward deregulation. However, Congress failed to approve Carter’s request to create a Consumer Affairs Agency and succeeded in blocking Carter’s tax reforms by referring them to committees where they were buried.

Carter believed that his election had helped the country forget the horrors of Watergate. He also tried to heal some of the wounds of the Vietnam War by granting a qualified amnesty to those who had evaded the draft. The compassionate government that Carter had promised was implemented through his push for welfare reform within the



United States and an emphasis on human rights in foreign policy decisions. Rather than placing an emphasis on the build up of nuclear weapons, Carter led the move toward negotiation of the SALT II agreement, which was signed in Vienna in June 1979. The Salt II Treaty would have limited the arms build up internationally, but it was derailed when the Soviet Union invaded Afghanistan in December 1979, a move that led Carter to boycott the Winter Olympics in 1980 and to invoke a number of economic sanctions against the Soviets.

Without a doubt, Carter's most successful foreign policy effort was the Camp David Accords of September 1978 that brought about a peace agreement between Israel and Egypt after 12 days of negotiation at the presidential retreat. The Accords were signed by Anwar Sadat, the president of Egypt and Menachem Begin, the prime minister of Israel, at the White House on September 1978. Carter would later win the 2002 Nobel Peace Prize for this and similar efforts worldwide after his presidency.

It has been argued by scholars that the most serious mistake of the Carter presidency occurred when he allowed the deposed shah of Iran to seek medical treatment in the United States in 1979, and refused to return him to the Iranians. This move angered the Iranians and led to the taking of 65 United States embassy personnel as hostages in November 1979. The media pounced on the hostage situation, and the result was that the American public began to feel that the hostage situation was the country's number one priority. The media focus constantly reminded the public that the president had not been able to bring about a successful rescue. To enforce their point, every night television cameras showed Iranians burning the American flag and announced how many days the hostages had been held.

As the situation continued, Carter's approval ratings dropped to a low of 21 percent. To show their disapproval of Carter, the Iranians held the hostages until the very moment that Ronald Reagan was sworn in as president. With rare tact, Reagan appointed Carter to the American team that traveled to Germany to welcome the hostages as they debarked from the plane.

An oil embargo and the problems in Iran contributed to an energy shortage that infuriated the American public. The supply of gasoline fell between 10 and 15 percent in June 1979. The oil producing countries announced a 50 percent rate hike.

When an accident occurred in a reactor at Three Mile Island on March 28, 1979, confidence in nuclear energy also fell sharply. Inflation rose to 13.3 percent, compared with the 6 percent of 1977. The deficit rose to 73.8 percent, up from 53.6 when Carter took office. The combination of what the public saw as failed domestic and foreign policy defeated Carter at the polls in November 1980.

#### SEE ALSO

ethics; Nixon, Richard; Watergate; Vietnam War.

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*Carter set a higher standard in government and political ethics after the Watergate scandal of the early 1970s.*

## ***caveat emptor***

THE TERM *caveat emptor* derives from the Latin, meaning “let the buyer beware.” It is employed as a warning to consumers that, if they are not vigilant, they are likely to be bilked by any one of thousands of ravenous marketplace predators; be they home-repair salesman, stock market shills, those who offer CDs at bargain rates, or others of the hordes of fraudulent vendors. The issue is whether governmental groups ought to provide protection for unwary consumers or whether they ought to be left to look out for themselves and suffer the consequences.

The popularity of the term *caveat emptor* is seen in the 28,000 entries that can be retrieved from Yahoo! on the internet. Virtually all of the internet links contain warnings about the perils of one or another scam that is being perpetrated on an unknowing public.

Because of its linguistic roots in Latin, *caveat emptor* often is mistakenly assumed to be a product of Roman law. Actually, it first was used in Anglo-American treatises in the 18th century with the introduction of industrialization and mercantilism. Walton Hamilton, a Yale University law professor, pointed out that the idea of *caveat emptor* was created by businessmen on the pretense that there existed a long tradition that required purchasers to be wary.

It was claimed that such an arrangement made for a more alert and more intelligent buying public. But Hamilton demonstrates that this viewpoint was based largely on misinterpretations of old documents. In truth, Hamilton suggests, Roman law and English common law were notably protective of the consumer.

Whatever slight legitimacy the *caveat emptor* principle might ever have enjoyed, it makes little sense in a very complex world in which it has become impossible for a customer to evaluate the adequacy of what is being offered. It may have been possible for farmers to appreciate that a horse said to be seven years old was twice that age. But how many of us can tell if pajamas are dangerously flammable or that a house being purchased has structural flaws not visible to the naked eye?

Because of the increased complexity of human existence, *caveat emptor* has been severely limited and increasing liability for misrepresentation has been placed on sellers. The legal responsibility of

those purveying products has come to be labeled *caveat venditor*, let the seller beware.

## SECURITIES FRAUD

In one area of concern, securities laws exemplify the tendency to impose penalties for fraudulent stock market transactions. The story begins with the chartering of the South Sea Company in London in 1711, one of the first corporations to sell shares. The price of the stock surged wildly through shrewd word-of-mouth advertising, creating a speculative mania. The price was 73 when the stock first was issued; about nine years later it was selling for nearly 2,000. When the stock tumbled dramatically, King George I observed that the swindle had involved “ensnaring and defrauding unwary persons to their utter impoverishment and ruin.” An investigatory committee found evidence of bribes to members of Parliament and other unsavory tactics to artificially inflate the company’s market value artificially. Restrictive laws were enacted to control the selling of corporate shares.

The major move in the United States to brake stock market transactions was the passage of the Securities and Exchange Act in 1934. The U.S. Supreme Court, in several decisions, pointed out how the act sought to hobble the idea of *caveat emptor*. In 1963, for instance, the Court in *SEC v. Capital Gains Research Bureau* (375 U.S. 180), ruled that the restrictions imposed on stock deals should be interpreted “not technically and restrictively, but flexibly to effectuate [the law’s] remedial purpose.” Congress had sought, the court declared, “to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*, and thus to achieve a high standard of business ethics in the securities industry.” In that case, a brokerage firm had purchased stock for its own account and then recommended that its customers buy the same stock as a long-term holding. When the price rose in the short-term, the brokerage house quickly sold its shares. The Supreme Court declared that such behavior violated laws that prohibited any practice that “operates as a fraud or deceit upon any client or prospective client.” The excesses that had brought on the 1933 national economic depression provided the rationale for Congress and the courts to support consumer protection statutes.

In this spirit, the Supreme Court in 2002 upheld a civil judgment against Charles Zindford, a

stock broker, who had obtained the power of attorney to manage the portfolio of an elderly man and his mentally challenged daughter. When the man died some years later, it was found that the funds had been totally depleted, often used by Zindford for his own purposes. Zindford was convicted of wire fraud, a common charge in white-collar crime cases. The Supreme Court, reviewing the case, pointed out that *caveat emptor* no longer was the governing rule; it was Zindford's responsibility to see to the best interests of those who had trusted him.

#### SEE ALSO

wire fraud; mail fraud; scams; advertising fraud; defective products.

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## Celler-Kefauver Act

PASSED BY THE U.S. CONGRESS in 1950, the Celler-Kefauver Act strengthened previous antitrust legislation by amending sections and adding provisions to the Clayton Antitrust Act of 1914. It made the Clayton Act's anti-merger provisions more applicable and it outlawed more types of illegal inter-corporate holdings, mergers, and acquisitions.

The original antitrust legislation, the Sherman Antitrust Act of 1890, was utilized heavily during Theodore Roosevelt and William Howard Taft administrations. The legislation prohibited any action by private firms that would prevent the regulatory action of the U.S. market system. It encouraged a market system with a significant number of rivals in each industry, ensuring market competition. Empowered by the act, the U.S. attorney general is permitted to bring lawsuits against companies suspected of monopolizing. The act accounted for the historic antitrust cases against American To-

bacco and Standard Oil, resulting in these massive companies being divided into smaller ones.

The Sherman Act was met with controversy and difficulty. Plagued with vague language, the act often proved ineffective because of loopholes, which arose from the language difficulties. For example, the act only outlaws "monopolizing" explicitly in print, but does not ban the existence of a "monopoly," resulting in drawn-out legal battles over the interpretation of these terms.

In 1914, the U.S. Congress attempted to ameliorate the problematic Sherman Act by amending it with the Clayton Antitrust Act. The Clayton Act, composed by U.S. Representative Henry De Lamar Clayton from Alabama, clarified the interpretation difficulties by amending language and added specific examples of illegal actions by companies. Local targeted price-cutting, a type of price discrimination, was outlawed by the Act, along with horizontal mergers and acquisitions, and exclusive dealership agreements.

Soon after the enactment of the Clayton Act, the U.S. Congress established the Federal Trade Commission (FTC) with the passage of the Federal Trade Commission Act of 1914. Authorized to enforce federal legislation, the FTC utilized the antitrust legislation to continue to curb or regulate monopolistic companies. The Clayton Act, however, did not solve all of the difficulties surrounding antitrust legislation. It was necessary for price-discrimination practices to be defined further by the Robinson-Patman Act of 1936 and for powers to prevent illegal mergers and acquisitions to be expanded by the Celler-Kefauver Act of 1950.

### ANTI-MERGER ACT

Often referred to as the Anti-Merger Act, the Celler-Kefauver legislation significantly strengthened powers granted by the Clayton Act to prevent mergers which could possibly result in reduced competition. Whereas the Clayton Act only tried to prevent horizontal mergers, which is the merger of two companies that output similar products, the Celler-Kefauver Act attempted to prevent vertical and conglomerate mergers by forbidding companies from buying assets from competitors when it would result in reduced competition.

Vertical mergers, which occur when a vendor company merges with a customer company, were attacked by government officials under powers

granted by the act because they are thought to create entry barriers, barring fair access of another company with similar products to a possible consumer. Conglomerate mergers, which occur when a company uses its success, resources, and money from one market to attempt to create a monopoly over another, were challenged as well.

#### SEE ALSO

antitrust; Sherman Antitrust Act; Clayton Antitrust Act; Robinson-Patman Act.

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## Cendant

HENRY SILVERMAN WAS the toast of Wall Street in late 1997 as he prepared to merge his company HFS, successful franchiser of Avis, Ramada Inns, and real estate brokerage Century 21, with high flying CUC International, a company that sold memberships in discount buying clubs through direct-marketing to form Cendant.

Like many popular Wall Street companies, Silverman's HFS had delivered a 20-percent-plus growth rate through a program of continuous acquisitions. Wall Street rewarded the new deal with a rising stock price for Cendant, with the sexy concept of synergies from feeding HFS customer names into CUC's direct marketing channels. It was not until April 1998 that the new Cendant management discovered that former CUC executives had massively overstated earnings by \$500 million over three years.

Subsequently, Cendant's stock dropped, erasing \$13 billion in market capitalization, and CUC founder Walter A. Forbes resigned. As one commentator noted "once CUC's massive irregularities were uncovered it became clear that its core business, selling memberships was not the profit engine originally expected." Stockholders sued Cendant,

asking how they could have believed the hype, and whether Silverman, known as a savvy deal maker, could have so massively stumbled? Did his due diligence actually fail to uncover the fraud ahead of time, or was he a part of the problem? Inexperienced shareholders, if not professional money managers, were dismayed to discover that because the deal was structured as a merger of equals, HFS did not, in fact, have unlimited access to CUC's accounting books.

So, in effect, it was the ultimate "trust me" deal. Also, sharing at least moral responsibility would seem to be CUC's former accountants Ernst & Young, and investment bankers Bear Sterns which received \$30 million as financial advisers on the merger.

Cendant has come to stand for the system of belief that enabled the growth of the Wall Street "bubble" in the 1990s. HFS wanted to believe that direct marketing of memberships was profitable. Wall Street wanted to believe that a 20 percent growth rate was sustainable, and that with the effect of synergy, Cendant, under its star CEO Silverman, would go on making money at that rate. Cendant settled with shareholders by agreeing in December 1999 to pay \$2.83 billion, without admitting liability, and Silverman went on to rebuild the Cendant company.

Then, as the Enron bankruptcy debacle hit, it became public that like Enron, Cendant also relied on off-balance sheet partnerships, which further tarnished the stock in 2002.

#### SEE ALSO

accounting fraud; stock fraud; Enron Corporation.

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## Centennial Savings and Loan

THE SAVINGS AND LOAN scandal of the 1980s is the greatest white collar-crime in terms of monetary loss to date (2004). Hundreds of institutions collapsed due to illegal and fraudulent transactions.

Savings and loans were created in the 1930s as an alternative to banks that were limited to real estate loans within 50 miles of the institution. Their executives had to be familiar with local property values. Such conservative practices meant depositors were at virtually no risk of losing their money. To insure safety the Savings and Loan Federal Deposit Insurance Corporation was created in 1934 to shield depositors against even a remote chance of loss.

During the late 1970s, deposits were withdrawn from low-interest paying saving accounts when interest rates climbed. Savings and loans were, by law, limited to long-term low-interest real estate loans, making it nearly impossible to survive. Deregulation allowed savings and loans to pay higher interest and make loans for a wider variety of purposes. Deregulation also created the widespread use of brokered deposits or large sums of money placed with the savings and loan that paid the highest interest rate.

The savings and loan scandal was not the work of one institution. The distinction of Centennial Savings & Loan Association of Santa Rosa, California, was the blatant nature of fraud and how rapidly the institution inflated its paper value, making its executives and associates wealthy using brokered deposits. Centennial began in the small California town of Guerneville, California, with capitalization of \$2 million in 1977. The location was poor because real estate was in little demand, and there were few local depositors. Centennial struggled until Erwin "Erv" Hansen, who had a good reputation in the industry, was appointed president in 1980. Under Hansen, Centennial moved to Santa Rosa and started receiving brokered deposits putting hundreds of millions of dollars at his disposal.

In violation of regulations and sound banking practices, deposits were used to make loans to Centennial officials whose names were kept off the books. Funds were spent for the personal benefit of Centennial executives, wasting huge amounts on lavish consumption. A private jet, personal chef, parties, and a \$48,000 desk for Hansen were the tip of the iceberg. Hansen used Centennial's funds to pay for his personal extravagance. Centennial's Executive vice president, Beverly Haines, admitted embezzling \$2.8 million.

Centennial was also involved a link to organized crime, illustrating how legitimate savings and loans were endangered by a business relationship with a

criminal organizations; Centennial's personnel dealt with known organized crime figures. The end came in 1985 when Centennial collapsed losing \$165 million.

#### SEE ALSO

savings and loan fraud; bank fraud; organized crime.

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## Center for Science in the Public Interest

THE CENTER for Science in the Public Interest (CSPI) was founded in 1971, as one of the public interest groups borne out of the work of Ralph Nader. to study, advocate for and influence legislation to protect consumers. CSPI conducts research on a variety of topics, including food safety, scientific integrity, genetically modified foods, and alcohol. The organization reveals information about the content of products that manufacturers would often like to keep hidden from consumers.

For example, in 2002, the CSPI issued a press release informing consumers of a complaint filed with the Food and Drug Administration, describing how the Ben & Jerry's ice cream company had engaged in a pattern of deceptive advertising in labeling some of its products "all natural." In fact, the consumer group noted that products, labeled "all natural" in reality "contained artificial flavors, hydrogenated oils, or other factory-made substances."

The CSPI has also led an effort to influence the U.S. Congress to pass the Meat and Poultry Pathogen Reduction and Enforcement Act of 2003, which was meant to place stricter limits on contaminated meat entering the human food chain. This act was nicknamed Kevin's Law, after Kevin Michael

Kowalczyk, who died in 2001 at the age of two after consuming a hamburger that was contaminated with *e. coli* bacteria.

Since 1981, the CSPI has led a campaign to inform the public about the risks of drinking alcohol, and to promote its initiative for responsible marketing by alcohol producers. For example, in 2003, the organization fought to prevent a plane bearing the advertising logos of Budweiser Light beer from being placed on display at the National Air and Space Museum of the Smithsonian Institution. Also, the CSPI has advocated for strict limits on how alcohol can be marketed to the general public as well as to youths. CSPI has acted to demonstrate how the U.S. Office of National Drug Policy "spends nearly \$200 million per year on its media campaign, focusing on marijuana, cocaine, heroin, and other drugs, ignoring alcohol, by far the leading drug problem among young people."

The CSPI has also been a strong advocate against the overuse of antibiotic medicines. They note that doctors often prescribe antibiotics as a "quick fix solution for patients," although the drugs may not be indicated for treatment of the diagnosed illness. For example, many illnesses such as colds, are caused by viruses which are not treatable using antibiotics, and for which the prescription of antibiotics is inappropriate.

The overuse of antibiotics has led to the development of antibiotic-resistant strains of bacteria, which makes treatment of illnesses, such as tuberculosis, more difficult to treat. CSPI has also advocated for the reduction of antibiotics in livestock production. Many livestock feeds come laced with antibiotics to try reduce illnesses in the herd. The organization notes that, "Almost half of all antibiotics produced in the U.S. are used in livestock production." The overuse of antibiotics in livestock production can result in antibiotic-resistant strains of bacteria, and may allow for the introduction of these bacteria into humans.

Funding for the work of CSPI primarily comes from subscriptions to its publication the *Nutrition Action Health* newsletter, which documents the organization's research and advocacy work. Between 5 and 10 percent of its budget comes from grants given by foundations such as the Robert Wood Johnson and the Rockefeller foundations.

SEE ALSO

Nader, Ralph; Food and Drug Administration.

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## Central America

IN CENTRAL AMERICA, Panama has become notorious as a center of white-collar and organized crime, especially money laundering. Indeed, outside of the United States, Panama is the biggest money laundering center in the Western Hemisphere. More than 100 international banks operate in Panama's offshore banking system. Much of the money laundering is linked to the international drug trade. In 1993, the Paris-based Observatoire Geopolitique des Drogues (OGD) published a study on the connection of the drug trade and national security in which Panama was classified as a "narco-state" with high-level government officials implicated in illicit activity.

Much of this is due to the nature of the country's banking system. General Omar Torrijos, leader of the country's national guard, took power in a 1968 coup. The United States supported the Torrijos government and provided economic aid to Panama. As part of the aid package, the U.S. Agency for International Development sponsored a study that Panama had all of the prerequisites to become an important international banking center. The country possessed excellent communications facilities, it was a transportation hub, and it used U.S. dollars. In response to the U.S. recommendation, the Torrijos government passed legislation that opened the country to foreign banks and allowed for a great degree of secrecy and anonymity. The new banking laws allowed the offshore banking center in Panama to take off.

This system permits secret accounts to be held by both individuals and corporations. Furthermore, Panama's banking system permits tax-free interest income, attracting account holders from around the world. Also, companies can be organized with no public disclosure of the principals. These bearer's share companies are "owned" by whoever holds the physical certificate. Often, "strawmen" do the in-

corporation and are the initial shareholders. They then give the certificates to the true owners. The process is often carried out by lawyers who do not even know the real owners. There is little that foreign authorities can do, allowing Panama to become a leader in laundering money from the international drug trade. After passing through Panama, such funds are easily wired to other countries.

Geography and the role of the United States have also contributed to Panama's role as a money-laundering center. The country's proximity to the United States and its location between drug production in South America and drug consumption in North America make it an ideal place for laundering narcotics profits. The construction of the Panama Canal, the subsequent "dollarization" of the economy, and the presence and spending of the U.S. military in the Canal Zone also made Panama a favorable spot for processing funds earned from illicit activities. In addition, Panama has been relatively conflict-free compared to many of its Central American neighbors, providing a more stable environment for financial activity.

#### MANUEL NORIEGA

Much of the organized crime in Panama revolved around Manuel Noriega, the head of the Panama Defense Force (PDF) and the *de facto* leader of the country after the death of Torrijos in 1981. Noriega maintained tight control over the illegal activities carried out by the PDF and almost nothing was done without his consent. Furthermore, those who did not have the favor of the dictator suffered accordingly. Noriega sometimes sent his henchmen to seize large amounts of cash, in some cases totaling millions of dollars, before it could be laundered. In the cocaine business, Noriega favored Colombia's Medellín cartel, and therefore fed information on the rival Cali cartel to U.S. authorities. He even went so far as to shut down a bank in Panama for money-laundering—a first in the country—because one of the institution's owners was a leader of the Cali cartel.

At the same time, Noriega was able to mask his involvement in the drug trade and money-laundering by acting as a secret partner in Panamanian companies and banks. For example, Noriega and the PDF were linked to freight carriers and airline charter companies that brought money in and out of Panama to be laundered. Through such criminal in-

volvement, Noriega was able to amass a great personal fortune.

Noriega also allowed other money-launderers to operate in Panama as long as they properly paid off the dictator. One of the more well-known examples is that of U.S. marijuana dealer Steven Kalish. By 1983, Kalish was earning such extraordinary amounts of drug profits, he was having difficulty in laundering the cash in the United States and the Cayman Islands. He turned to Panama, and after an initial \$300,000 bribe to Noriega, Kalish was allowed to fly from the United States to Panama under diplomatic cover. Kalish continued to lavish frequent and expensive gifts upon Noriega in exchange for access to the airport in Panama City, where his planes loaded with cash could taxi to a corner of the airport controlled by the military. There, he could unload his drug money into waiting armored cars and take it to deposit in Panama City banks. Kalish continued these covert money-laundering operations until he was arrested in July 1984.

#### OUR MAN IN PANAMA

The United States was generally willing to overlook Noriega's illegal activities due to his cooperation with U.S. military and intelligence anti-communist operations. In particular, during the early 1980s, despite growing concerns about Noriega's money-laundering, the U.S. government looked the other way due to the Panamanian leader's support for the U.S.-backed Contra anti-communist rebels in Nicaragua. In 1986, authorities in the United States began to disclose that Noriega was involved in many illegal activities, ranging from drug-dealing and money-laundering to aiding guerrilla groups and assassinating political opponents. In 1989, the United States invaded Panama, captured Noriega, and sentenced him to jail time in the United States on drug charges. In addition to money-laundering and the drug trade, Panama has also been a center of immigrant smuggling and the production of fraudulent documents. For example, more than 100,000 undocumented Chinese immigrants have passed through Panama and other parts of Central America, including Guatemala and Belize.

#### ENRON AND GUATEMALA

In 2003, the U.S. Senate Finance Committee concluded that the Enron Corporation made more than

\$12 million in questionable payments to a group of businessmen in Guatemala. With the company's first major entry into the Latin American market, Enron hoped that the businessmen could use their contacts with President Jorge Serrano to secure utility contracts. The Texas-Ohio Power Company had signed a 15-year power supply deal with the Empresa Eléctrica de Guatemala. Texas-Ohio then sought out help from Enron in order to finance the project. In addition, the World Bank, the U.S. Department of Transportation Maritime Administration and the Overseas Private Investment Corporation all contributed funds to the endeavor. Texas-Ohio then made a deal with the Sun King Trading Company, a group of four prominent Guatemalan businessmen and one American, who negotiated with high-ranking Guatemalan officials in exchange for a percentage of future revenues. Enron then built a 110-megawatt power plant, placed it on a barge, and stationed it near the Guatemalan city of Puerto Quetzal in order to sell electricity to the government-owned utility.

The Senate investigation found the Sun King Trading Company performed no real services and the payments made to them over a four-year period were nothing more than bribes. The company's basic role was to make connections with the Guatemalan president and convince him to sign the Enron agreement. Under the U.S. Foreign Corrupt Practices Act, U.S. companies are prohibited from paying bribes. Furthermore, Enron disguised the bribes as fuel payments and even tried to claim tax deductions on them. Then in 1995, an Enron whistleblower brought the Guatemala situation to the attention of the Internal Revenue Service. The information was then passed on to the Justice Department and the Securities and Exchange Commission, but no U.S. government agency pursued prosecution against Enron.

## HONDURAS

By the late-1980s, organized crime became a major issue in Honduras, as the country became an important trans-shipment center for the Colombian cocaine cartels. The Colombians took advantage of the relaxed ethical standards of the Honduran military in light of its connection to the U.S. fight against the pro-communist Sandinista regime across the border in Nicaragua. Furthermore, Colombia's Medellín cartel could offer even more money than

the millions of dollars that Honduras received from the United States, supposedly to aid democracy. In addition, the Honduran military had reported links to Panamanian leader Noriega. The country's armed forces also was involved in laundering drug money and using profits from the narcotics trade to pay off political parties.

A relatively corrupt civilian government was not interested in investigating the involvement of the Honduran military in organized international crime, nor did the U.S. embassy take much notice, as national security and geopolitical concerns took precedence. Due to the fact that Honduras played the important role as a base for the U.S.-backed Contras who were fighting the Sandinista government in Nicaragua, the U.S. government was willing to look the other way. In addition, the military in Honduras controlled both the police and the country's airports, giving it much latitude in conducting illegal activities.

The military itself had little direct connection to the Colombians. Rather, a Honduran national, Jose Ramon Mata Ballesteros, who had connections to Noriega, acted as a go-between for the Medellín cartel and the Honduran military. Mata was the head of the so-called Padrino trafficking organization that supplied the Colombian drugs to Mexico and the United States. He had spent many years in Colombia and became a very wealthy man. After escaping from jail in Colombia, he returned to Honduras in 1986 because his native country did not have an extradition treaty with the United States, where Mata was a wanted in connection with the murder of U.S. Drug Enforcement Agency agent Enrique Camarena Salazar.

While at first the United States ignored the Honduran drug connection, eventually reports surfaced that weapons flowed through the country to leftist groups in El Salvador and Nicaragua, and the United States decided to crack down on the Honduran drug trade. U.S. pressure and factional splits within the armed forces in Honduras led the military to arrest Mata in 1988, and to send him to the United States where he was arrested. Many believe that the Honduran military handed over Mata to satisfy the United States in hopes that there would not be an investigation into the involvement of military officers in the drug business.

Two days after Mata's arrest, a list of military officers reportedly linked to the narcotics trade was made public. This, combined with a growing anti-



American sentiment over the Mata case, a major demonstration took place at the U.S. embassy. At least five people died and an annex at the embassy burned down.

Some claim that the Honduran military organized the demonstration to pressure the United States to drop any potential drug investigation. Others say the demonstration was meant to undermine the authority of the military. Whatever the truth, the government declared a state of emergency in the country's two largest cities.

This action broke the major link between the Colombians and the Honduran military. In addition, U.S. radar installations, previously directed toward use against the Sandinistas, were now used to track drug flights.

The U.S. judicial system sent Mata to a maximum security federal prison on drug charges. However, in Honduras, many still considered him to be a hero to the poor, a Honduran Robin Hood. Worth more than \$1 billion, Mata spent lavishly on schools, hospitals, athletic teams, and community groups. Many poor Hondurans sought and received his help. Authorities argue that Mata was simply a criminal trying to divert attention away from his links to drug cartels in Colombia and Mexico.

#### SEE ALSO

South America; Bush, George H. W.; Iran-Contra; North, Oliver; money laundering; organized crime; drug trafficking.

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## Challenger Disaster

ON JANUARY 28, 1986, only 73 seconds after launching of Mission 51-L, seven crewmembers including a schoolteacher, Christa McAuliffe, died in the explosion of the space shuttle *Challenger*. A

subsequent investigation by the President's Commission on the space shuttle *Challenger* Accident (the Rogers Commission) concluded that the cause of the *Challenger* explosion was the failure of the O-ring pressure seal in the spacecraft's right solid rocket booster.

O-ring seals are designed to prevent hot gases from leaking through the joint during the propellant burn of the rocket motor. However, almost immediately after takeoff the O-ring seals were destroyed allowing hot gases to leak through the right solid rocket motor field joint. In the process, the struts linking the solid booster and the external tank began to weaken. Eventually, the solid rocket booster was allowed to rotate freely and impact the intertank structure and the lower part of the liquid oxygen tank. Continuous structural failure to the hydrogen tank released large amounts of liquid hydrogen. This combination of events created an enormous oxygen-hydrogen explosion that engulfed the *Challenger* within seconds.

The commission's report stated that gray and black smoke emitted from the right solid rocket booster was an indication that grease, joint insulation, and rubber O-rings in the joint seal were being burned and eroded by hot gases. Beyond the technical cause of the explosion, the commission and other scholars maintain several factors contributed significantly to the tragedy including pressure placed on the National Aeronautics and Space Administration (NASA) to sustain a busy launch schedule (15 launches were scheduled for 1986 and another 19 for 1987). Faulty design of the spacecraft, weather temperatures, and a lack of organizational communication also contributed to the crash.

The space shuttle *Challenger*, named after the British Naval vessel HMS *Challenger*, was the second orbiter to become operational at Kennedy Space Center. During the 1960s, NASA enjoyed unlimited political support and financial resources. However by the 1970s, budget constraints and a lack of political and public support dramatically affected NASA's ability to design a fully comprehensive reusable spacecraft. As a result, NASA made several compromises in its spacecraft design, often in favor of cheaper but more dangerous parts. For instance, instead of using safer liquid-fueled engines, NASA used the more volatile solid-fueled rockets. By the 1980s, the Ronald Reagan Administration placed tremendous pressure on NASA to

accelerate the use of the space program for commercial, military, and scientific purposes. This emphasis on a fully operational space shuttle program meant that NASA had to further compromise shuttle designs in order to meet political desires and demands for a rapid launch schedule. The result was a hybrid design of the space shuttle that generally overlooked some safety issues.

As early as 1978, several engineers at NASA's Marshall Space Flight Center expressed concern about Morton Thiokol's design of the field joint. Thiokol was the primary private business contracted by NASA to build the solid rocket booster. Marshall engineers agreed that Thiokol's faulty design could lead to hot gas leaks that would essentially cause catastrophic failure. Indeed, Marshall classified the O-ring seals as "criticality 1" meaning they did not meet space shuttle requirements for adequate failsafe standards. Further tests confirmed Marshall engineers' fears that the secondary O-rings were dysfunctional and subject to extreme erosion and damage. Despite this evidence, Marshall continued to define the problems with the O-rings as an acceptable risk. The *Challenger* was also designed with several used parts. Two of the solid rocket motors had been previously used and had grown in terms of diameter. Consequently, the O-rings designed to prevent seepage or gas leaks did not completely seal the opening.

Weather conditions were also a concern. Engineers at both Thiokol and Marshall discovered that the O-rings did not properly compress and contract in low temperatures. The failure of the O-ring to return to its original rounded shape meant that the gaps in the field joints would not be properly sealed, and thus would allow gases to freely pass through the rocket booster. This became a significant safety factor because, at the time of the *Challenger* launch, temperatures were an uncharacteristically low 36 degrees Fahrenheit.

On the eve of the *Challenger* launch, engineers from Thiokol adamantly expressed their concerns about the cold temperatures to Marshall engineers. Thiokol advised against the launch at temperatures below 53 degrees Fahrenheit because of the potential failure of the O-rings. However, due to intense pressure, Marshall officials insisted on proceeding with the launch of the *Challenger*. The launching of each shuttle became the top priority of the agency; the completion of shuttle launches was essential to the long-term survival of the space program.

Media attention to the *Challenger* launch was usually intense because of the inclusion of McAuliffe as part of the space shuttle crew. This marked the first time that a private citizen would be present on a ride to space. McAuliffe was scheduled to deliver a school lesson from space to millions of students. Also, Reagan was scheduled to give the State of the Union address on the night of the launch. Under these conditions, Marshall officials ignored advice from the Thiokol engineers regarding the safety of the spacecraft under cold weather conditions.

In addition, Marshall officials failed to communicate their concerns about the O-rings, or their knowledge of other potential problems to various departments and officials within NASA. The commission cited Marshall's reluctance to communicate important information as a major reason the *Challenger* launch was allowed to proceed.

#### SEE ALSO

Morton Thiokol; corporate liability; whistleblower.

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## charity fraud

CHARITABLE organizations solicit funds from the public for philanthropic goals such as seeking cures for diseases, or aiding the families of slain police officers. Fraud occurs when donations are solicited in a deceptive manner or are used for purposes never intended by the donors. Charities are also subject to the kinds of fraud that plague all business organizations, such as embezzlement and misappropriation of funds by executives.

It is not always easy to establish and prosecute charity fraud. All scholars would agree that money

solicited by persons or groups that are not legitimate charitable organizations would constitute charity fraud, but the question of fraud is complicated when considering charities that use, for example, a very high percentage of donations for administrative costs or additional fundraising rather than for the charitable cause. These kinds of issues, as well as the very large number of charitable organizations worldwide, make charity fraud difficult to monitor and eradicate.

Fraud affects only a very small percentage of the money Americans donate to charities, which totaled \$212 billion in 2001, according to the Federal Trade Commission, but its effects are damaging far beyond the initial crime. Charity fraud is perceived as a particularly abhorrent kind of deceptive business practice because it abuses the trust of altruistic persons who offer donations with the expectation that they are assisting those in need.

Widespread or infamous cases of charity fraud can result in a lasting backlash because those responsible have manipulated the emotions of donors in order to elicit a donation, leading to anger and disillusionment if it is revealed that the charity and philanthropic promises were invalid. This disillusionment and suspicion caused by fraudulent charitable solicitation or misappropriation of funds has the additional very damaging effect of tainting the fundraising appeals of legitimate charities, which suffer by association with those who defraud donors.

## SEPTEMBER 11 FRAUD

Incidences of charity fraud are often collected around crises that attract national attention. The September 11, 2001, terrorist attacks resulted in one of the largest outpouring of charitable support in American history; the powerlessness of most Americans in the face of the attacks meant that they wished to help in some way, and for many this entailed a charitable donation.

The United States General Accounting Office estimated that \$2.7 billion was donated to September 11 causes, while the Better Business Bureau placed that number at \$2.8 billion, with about a third of the total money collected going to the Red Cross. The Red Cross came under scrutiny over its use of the funds as significant amounts of Red Cross donations were held in reserve and not distributed to victims' relief efforts. The scale of the

September 11 relief effort made it likely that fraudulent charities would spring up to take advantage of this fervent desire to help, despite the vehement public distaste for such profiteers in a time of crisis.

Investigations by the attorney general of New York garnered a handful of suspicious cases, though none resulted in charges of organized fraud as of late 2003. The U.S. Senate's Committee on Finance tracks the ongoing investigations of fraud related to September 11 charities. Typical cases include charities that have not registered as such, so are suspect in their motivations and mission, and money collected that does not seem to have yet made its way to victims.

## MISREPRESENTATION

Charities may be guilty of fraud when they mislead donors about the percentage of contributions that is applied to various business expenses, thereby vastly overstating the amount of the contribution that will go to the charitable cause. All charities have some administrative costs, but some charities have exorbitant overhead costs that result in almost none of the donation actually going to the charitable cause.

One recent case involved the charity VietNow, which solicited donations for veterans of the Vietnam War. The Better Business Bureau Wise Giving Alliance (BBB WGA), an oversight organization that monitors charities, determined that 91 percent of donations were being used for additional fundraising, and only 3 percent for charitable purposes. The BBB WGA argued that VietNow should have revealed these percentages to its donors, who may have acted differently if they had this information. It is important to note that high administrative costs, though perhaps reprehensible to donors, are not necessarily in and of themselves prosecutable as fraud. In May 2003, the Supreme Court gave the go-ahead to states to prosecute charities or fundraisers that intentionally misled donors, but affirmed that high administrative costs do not automatically constitute fraud.

Charitable organizations may act in a fraudulent way by misrepresenting themselves or associating themselves in a deliberately vague way with known, famous, charities or governmental associations for the purpose of obtaining donations. An example of this kind of deception on the part of a charity is the case of the Police Survivors Fund. It was estab-

lished in 1999 and disbanded by 2003 when its founder pleaded guilty to various fraud charges. The aim of the Police Survivors Fund was to aid widows and children of police killed on the job.

Though this aim was clearly stated in telephone solicitation calls, other factors were left more vague. Consumers may have been confused by the name of the organization as stated during the telephone solicitations because it sounded official. The actual connection between any municipal police force and the Police Survivors Fund was not made clear to donors, because there was no such sponsorship of the charity by a police force, despite the official-sounding name. The Police Survivors Fund had a fundraising strategy familiar to prosecutors of charity fraud. Fundraisers would tell those who were solicited that the donation was for widows and children. They initially ask for a large sum, such as \$1,000, and then revise it to a lower figure if the potential donor balks, implying that a \$99 donation was the least that could be done for the "widows and children." The founder of the Police Survivors Fund also used the September 11 terrorist attacks as a marketing tool, mentioning vaguely that his group was coordinating efforts with a "World Trade Center fund" and noting that other donors had given \$911 as a symbolic figure to commemorate the attacks. He collected \$441,000, only \$14,500 of which was actually given to survivors of slain police officers. Fraudulent fundraisers may also intimidate those they call by misrepresenting the result of refusing a donation, using fear (suggesting that police departments will no longer answer calls from the residence of a hesitant donor, for example) or social pressure.

Legitimate and well-meaning charities that do not engage in the practices described above do not necessarily escape charges of fraud, because they may also suffer from mismanagement of funds by charity executives. Perhaps the most famous example of a scandal affecting a well-respected charity is the 1995 case involving the former president of United Way of America, who received a seven-year prison sentence for using money donated to the charity to fund his personal expenses, including lavish vacations and support for mistresses.

## CHARITIES AS VICTIMS

Charities that are constantly seeking new fundraising opportunities may also themselves fall victim to

fraudsters. Many charities depend for fundraising on third-party fundraisers, usually for-profit businesses, which open the door to additional possibilities for fraud. Charities may be victimized by fundraisers that refuse to deliver the donations raised, or alternately will only pass on a much lower percentage of collected funds than originally promised.

Another example of a fraud perpetrated through charities is the mid-1990s case of the Foundation for New Era Philanthropy. It lured investment from charitable organizations by promising a double return on the initial investment. The chief executive of New Era Philanthropy claimed that the returns would come from philanthropists who were seeking organizations for charitable donations, though in truth he was running a pyramid scheme, in which later investments were used to pay off earlier ones. When the company filed for bankruptcy in 1995 it took with it the investments of charitable organizations who could ill afford to lose such large sums of money, especially in the eyes of the donors who were funding the bad investment decision.

The most onerous difficulty in eradicating charity fraud is that a charitable donation is often an impulsive decision, based on information about the charity offered solely at the time of solicitation by the person making the request. In addition, the methods of solicitation used by fraudulent charitable organizations such as direct mail and telephone soliciting are also methods used by legitimate charities. For a person deciding on the spot whether or not to make a donation, it can be daunting to try to determine if the charity is legitimate, if it is well-governed, and if an acceptable percentage of the money it collects is funneled to the charitable cause.

## FIGHTING FRAUD

A key strategy for avoiding charity fraud is the education of potential donors about services provided and percentage of collected funds used for charitable purposes; donors may then make an informed choice about the organizations they wish to support.

The internet has helped enormously in educating donors about legitimate and criminal charitable organizations, because charities and charity oversight organizations are better able to reach concerned donors and disseminate information on a scale far beyond what was possible in the past.

Charities often attempt to distinguish themselves from illicit organizations by including information in their solicitations about their activities and overhead costs, understanding that trust is a crucial issue when it comes to charitable fundraising. It is important also that this information about charities is readily available because donors are often not knowledgeable, savvy, or willing enough to do the research needed to seek out this kind of information.

Charity monitoring organizations also play an important role in eradicating fraud and providing information to donors about charities. There are a number of oversight organizations that attempt to educate and protect the public from charity fraud. The American Institute for Philanthropy publishes ratings for charities on its website, ranging from an A for excellent to a grade of F for poor ([www.charitywatch.org](http://www.charitywatch.org)).

Another such oversight organization is the Better Business Bureau Wise Giving Alliance (BBB WGA) mentioned above. Formed by the 2001 merger of the National Charities Information Bureau and the Philanthropy Advisory Service of the Council of Better Business Bureaus, it has established guidelines for charitable organizations. The BBB WGA Standards for Charitable Solicitations require: that solicitations are accurate and truthful, and not misleading; that they offer a clear description of the programs that will be funded by the donation; that it should be at all times clear during the solicitation what the organization is, what the relationship between the solicitor and the organization is, and how the funds donated will be used.

These guidelines also indicate that fundraising should not be done with excessive pressure, and that charities should have an active and independent governing body that includes at least three persons who meet at least three times annually. The BBB WGA conducts investigations of charities and publishes research reports on its website ([www.give.org](http://www.give.org)); a very large number of charities are covered and donors may conduct a search to determine the credibility and statistics associated with a particular charity.

But oversight organizations are in a bind because all charities depend on the sympathy and impulsive generosity of donors. In order to eradicate fraud, charities must insist that the donation not be impulsive but rather well-researched. In general, oversight organizations recommend that prior to

giving, donors should request a copy of an annual report or a financial statement; write checks only to the charity, never to an individual; and never give cash, because it does not leave a paperwork trail. In general, at least 65 percent of contributions should be funneled to the charitable cause, rather than for overhead costs, such as salaries for charity employees, mailings, and start-up expenses.

Federal and state governments and governmental associations also play a role in eradicating charity fraud. For example, the Federal Trade Commission collects information on charity fraud, and publishes a guide called *Charitable Donations: Give or Take?* on its website ([www.ftc.gov](http://www.ftc.gov)). The U.S. Postal Service also has an information program about charity fraud, since many charitable appeals are routed through the U.S. mail. In the past the Postal Service has sent out postcards to consumers warning them about the kinds of fraudulent charitable requests that may appear through the mail. State governments also have material to educate donors about charity fraud on their official websites.

Charitable organizations play a crucial role in the social structure of a democratic society. Despite all of the correctives listed above, fraud will likely continue to be perpetrated by illegitimate or ill-meaning charitable organizations. Victims of charity fraud will continue to be generous with their donations, because they are attracted by an appeal that plays on their emotions at a time when they are perhaps otherwise distracted and unable to do the research required to determine if a given charity is worthy.

#### SEE ALSO

nonprofit organization fraud; Better Business Bureaus; Federal Trade Commission; scams; mail fraud; telemarketing fraud; internet fraud; advertising fraud.

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## check kiting

CHECK KITING IS A FRAUD committed against a banking institution, in which the underlying premise is to gain access to deposited funds before they are collected from the institution upon which they are drawn. The scam usually involves several checking accounts spread between several banks. In effect, a bank deposits money into an account while waiting for cash to be processed from another account; while in actuality the other account holds no money. An example of check kiting would be as follows:

*Monday.* A prospective check-kiter deposits a \$500 check from account A into account B; then shortly thereafter deposits a \$500 check from account B into account A.

*Tuesday.* Another round of deposits are made as well as some partial withdrawals.

*Wednesday.* One bank collects its monies from account A, while another collects its monies from account B. There is no actual money in either account, with all checks being drawn on insufficient funds, just a float of alleged funds being transferred back and forth between the two accounts. The check-kiter creates fictional balances in each account where none exists to obtain the use of the cash balances. The process of kiting is an extension of a shell game, moving the prize (the alleged cash balance) from one shell to another. Only when the process is halted, either by an alert banking institution or by the kiter, is it discovered that no monies exist. It is all a con.

As the kiting process continues, the dollar amount rises, as well as the number of accounts. A recent case in Michigan involved 21 accounts and a \$32 million loss. Affected banks are under no obligation to advise another bank of a possible kiting scam, as the last bank holding the checks is the banking institution that incurs the loss. According to the Office of the Comptroller of the Currency,

banks incur approximately \$12 billion losses annually from check kiting scams. Some would interpret this calculated use of the Expedited Funds Availability Act as aggressive cash-management; while others would declare it a criminal act.

Indications of a potential check kiting operation include: Several accounts owned, or controlled by, the same individual; identifiable patterns of transactions, including deposits, transfers, and withdrawals between those accounts; deposits drawn on other institutions by the same holder of the accounts the funds are being deposited to; and frequent inquiries into account balances, collected items, and cleared items.

Changes in applicable federal statutes (1990 amendment to Section 1344 of Title 18, U.S. Code) reduce the burden of proof in prosecuting check kiting, removing both the issue of intent and accepted complicity by the banking institution.

### SEE ALSO

bad checks; bank fraud; scams.

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## Chem-Bio

MISTAKES IN interpreting pap smears at this Wisconsin laboratory cost two lives, resulting in the first case of criminal prosecution for lab errors. In 1996, the lab was fined \$20,000 for missing signs of the cervical cancer that killed Dolores Geary and Karin Smith. Family Health Plan, a regional health maintenance organization (HMO) contracted with Chem-Bio for processing of medical samples.

Questions would later be asked about the influence of one Chem-Bio co-owner, Dr. Robert Lipo, who also sat on the board of Family Health Plan. The tests processed by Chem-Bio included routine Pap smears: testing of cells scraped from the cervix for signs of cervical cancer. With early detection,

cervical cancer is virtually always curable, according to the National Cervical Cancer Coalition.

Chem-Bio's labs, also supervised by Lipo, seemed to meet the HMO's needs for speed, efficiency, and low cost. One source of Chem-Bio's efficiency may have been a policy of paying cytotechnologists, such as June Fricano, on a piecework basis, with pay depending on the number of slides processed. Fricano, who had more than 25 years of experience, claimed to be able to read between 180 and 200 slides per day, well above the number suggested by professional guidelines. It was Fricano who misread Geary's 1987 and 1990 Pap smears, Smith's 1988 and 1989 pap smears, and Smith's 1989 and 1990 biopsies. Both women had cervical cancer that was not diagnosed until it was too far advanced for effective treatment. "There is strong evidence she [Fricano] never read any of the slides from Dolores Geary or Karin Smith," declared Circuit Judge David Hansher in sentencing the Chem-Bio for reckless homicide.

## CHARGES FILED

Criminal charges against Chem-Bio were the last step in the long road of litigation. In 1991, Geary, Smith, and their families filed civil charges for medical malpractice against Chem-Bio, Family Health Plan, and other defendants. Each family settled out of court: the Gearys for \$3.5 million and the Smiths for \$6.3 million. Only after the 1993 death of Geary, a 40-year-old mother of three, and the 1995 death of Smith, a 29-year-old accountant, did the Milwaukee County District Attorney consider criminal charges against Chem-Bio.

At an inquest hearing in April 1995, experts testified that the disputed slides showed clear evidence of cervical cancer. The six-person jury recommended pressing reckless homicide charges against the company and, separately, against Lipo and Fricano. Chem-Bio pled no-contest in December 1995. The state appeals court refused to hear Chem-Bio's request for dismissal on the grounds that a corporation could not be charged with homicide. In February 1996, Judge Hansher exacted the harshest financial penalty allowed by statute: \$10,000 per victim. Hansher characterized the penalty as "absolutely inadequate."

Milwaukee County District Attorney E. Michael McCann boasted that he had been officially censured by the Medical Society of the State

of Illinois. Lipo and Fricano avoided prosecution by negotiating agreements with McCann. Lipo promised that he would not supervise tissue testing or act as a lab medical director for six years. By 1997, he was teaching in the Department of Pathology at the Medical College of Wisconsin. Fricano, who had already found employment at another lab, promised to take additional training and to refuse any position that involved payment by the slide.

Although medical ethicist Arthur Caplan predicted in the *Los Angeles Times* a "criminal prosecution crisis" that would push doctors and HMOs to "the edge of complete paranoia," similar cases have remained rare.

## SEE ALSO

medical malpractice; healthcare fraud; negligence.

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## Chevron

CHEVRON, or ChevronTexaco since the merger with Texaco in 2001, describes itself as an integrated energy company based on oil-equivalent reserves and production, and is the second largest U.S.-based integrated oil, gas, and chemical company. As of September 2003, the company was the world's fourth largest publicly-traded oil major active in more than 180 countries, employing just over 50,000 people.

Worldwide, the company operates 23 wholly owned and joint-venture oil refineries, and 32 chemical manufacturing sites through a 50-50 joint venture with ConocoPhillips. It has acquired the reputation of being one of the most conservative oil companies. Like many oil companies, Chevron has been accused of illegal price-fixing, tax evasion

and contravening environmental regulations. According to the U.S. Public Interest Research Group, Chevron paid more than \$70 million in fines, settlements and penalties between 1980 and 2001. The company's participation in a consortium seeking permission to drill in the Arctic National Wildlife Refuge has attracted the ire of conservation and environmental movements in the United States. Consequently, Chevron's record on health, safety, and environmental issues has come under close scrutiny.

Chevron traces its origins to the Pacific Coast Oil Company founded in 1879 by San Francisco businessman Charles N. Felton. In 1900, the Board agreed to sell the company to the Standard Oil Company of Indiana, part of John D. Rockefeller's Standard Oil Trust. In 1906, the Standard Oil Trust consolidated its West Coast holdings, forming the Standard Oil Company (California). In 1911, the company regained its independence after the breakup of the Standard Oil Trust. In 1926, the company merged with the Pacific Oil Company, renaming itself the Standard Oil Company of California or Socal. The need to secure oil supplies and the perceived U.S. energy crisis after World War I forced the company to increase exploration activity both inside and outside the United States.

## ARABIAN OIL

In 1928, the company bought an oil concession in Bahrain from Gulf Oil, and struck oil in 1932. The company secured an oil concession in neighboring Saudi Arabia in 1932, forming California Arabian Standard Oil Company (Casoc) to operate the concession. Casoc struck oil in 1938. Although the company was a major player in the oilfields of California, Texas, and the Gulf of Mexico, the Saudi Arabian fields remained the company's main source of crude oil until 1980. Socal did not have enough outlets to sell its Saudi Arabian oil so the company formed a joint marketing company with Texaco called Caltex.

In the late 1970s, Socal executives believed the long-term future for oil companies was bleak, but was slow to diversify into other businesses. The company launched an unsuccessful bid in 1979 for the mining company AMAX. A similar bid failed two years later. The company did, however, redefine itself as an energy company, diversifying into uranium mining among other things. The environmen-

tal legacy of the company's uranium milling activities at Panna Maria, Texas (1979–92) remains the subject of controversy. Local campaigners suggest the company used the site as an unlicensed radioactive waste dump.

In 1984 Socal merged with Gulf Oil, rescuing Gulf from a hostile takeover by T. Boone Pickens. The new company, Chevron, was criticized for maintaining operations in South Africa and Angola by both anti-apartheid activists and conservatives. Chevron also inherited Gulf Oil's operations in Nigeria. Like Shell, the other major operator in the area, Chevron has been accused of complicity in human rights violations. In May 1998, Chevron flew members of the Nigerian Navy and Mobile Police to protect one of its oil platforms in the Niger delta. Three days earlier, 121 protesters from local communities occupied the platform to protest against the environmental damage caused by the company's operations and the failure of the company to contribute to development in the Niger delta. The troops and the police shot at the protesters, killing two and wounding many more, while regaining control of the platform.

## CHEVRON CASE STUDIES

In 1988, four years after the merger with Gulf Oil, Chevron acquired Tenneco's oil and gas reserves in the Gulf of Mexico in an attempt to compensate for the loss of their assets in Saudi Arabia after the Saudi government nationalized the industry in 1980. According to the Public Interest Research Group, Chevron's operations in the Gulf of Mexico have a poor safety record. Between 1956 and 1989 offshore rigs operated by Chevron have experienced 10 gas blowouts, 65 fires and explosions, 14 significant pollution incidents, 40 major pollution incidents and five pipeline breaks or leaks.

The study, *Big Spillers*, published by Essential Information in 1989, confirmed Chevron's reputation as the biggest spiller of oil. Between 1984 and 1989, Chevron spilled a total of 2.8 million gallons of oil, excluding millions of gallons that leaked from the company's El Segundo refinery into the underground water table. Eighteen years earlier, two Socal tankers collided near the Golden Gate Bridge, spilling approximately 840,000 gallons of oil into the San Francisco Bay.

Private individuals and regulatory authorities have regularly taken Chevron to court for oil spills,



drilling pollution, hazardous waste violations, and illegal air and water pollution since the mid-1980s. In 1992, a refinery pipeline broke at the Kenai terminal owned by Atlantic Richfield (ARCO) and Chevron, spilling 47,000 gallons of a North Slope crude oil-water mix into Cook Inlet, Alaska. Frozen water in the tank prevented a helicopter spray of dispersants; only 2,400 gallons of oil were recovered. The companies had to pay a \$90,000 fine to the State of Alaska. In May 1992, the president of Chevron USA appeared in federal court to plead guilty to 65 violations of the Clean Water Act, for illegal discharges from platforms off the California coast and paid \$6.5 million in criminal fines and \$1.5 million in civil fines.

Officials from the Environmental Protection Administration (EPA) found that Platform Grace, a Chevron drilling platform in the Santa Barbara channel, was discharging oil and grease in wastewater that exceeded limits in its federal permit. Chevron also admitted to diluting wastewater prior to its being sampled, so as to understate the actual amount of oil and grease discharge, which it reported to the EPA. As of 2001, the EPA listed Chevron as a "potentially responsible party" for 49 hazardous waste Superfund sites, more than any other oil company. In August 2000, Chevron paid a record \$7 million dollars to settle claims that it violated the Clean Air Act at its offshore loading terminal near El Segundo, California. The settlement includes a \$6 million penalty, the highest ever paid under the Clean Air Act for a single facility, and environmental projects valued at \$1 million.

During the past two decades, Chevron has also been accused of illegal price-fixing and tax evasion. In July 1981, Socal reached an out-of-court settlement with the Justice Department over allegations that the company of evaded oil price control overcharging consumers between 1973 and 1981. Socal paid \$82.5 million but did not admit any wrongdoing. The Internal Revenue Service charged Chevron and the other companies involved in Aramco with evading taxes during the period 1979-81. According to the IRS, the companies bought Saudi Arabian crude oil for considerably less than the market rate, routed it through their foreign subsidiaries and marked up the price to avoid paying the full-rate of tax on profits from selling the oil.

During the 1990s the federal government and various states also accused Chevron and other oil companies of evading oil royalty payments by un-

dervaluing oil produced on land leased from federal or state authorities and overvaluing the cost of transporting the oil. Chevron has settled many of these claims.

#### SEE ALSO

Conoco; price fixing; price discrimination; tax evasion; air pollution; water pollution; Environmental Protection Agency; Clean Air Act; Clean Water Act.

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## China

THE CONTEMPORARY history of China has seen the adoption of new economic and social policies to facilitate the switch to a market-based economy and opening China to the outside world. Such policies have brought great changes in every sphere of work. The problem of white-collar and corporate crime is becoming a major public concern since China implemented the economic reform and "open door" policies in the late 1970s and early 1980s. By Chinese definitions, white-collar and corporate crimes, usually called economic crimes, refer

to activities by various illegal means in diverse links of the so-called socialist market economy, such as producing and marketing fake or substandard goods, selling smuggled goods, disrupting the order of administration of companies, disrupting the order of financial administration, financial fraud, jeopardizing administration of tax collection, intellectual property crimes, and disrupting market order. Also included are such lawbreaking conducts as property fraud, graft, offering or accepting bribes, embezzlement, dereliction of duty, environmental crimes, and various organized business crimes.

### CRIME AND COMMUNISM

The problem of white-collar and corporate crime is serious in China as it has eroded the Chinese communist regime over 50 years. The incidence of economic crimes in China were present in the early stages Chinese communism. On December 29, 1951, the National Committee of the Chinese People's Political Consultative Conference issued a "directive on the production increase and austerity movement and anti-corruption, anti-waste and anti-bureaucratic struggles." The directive admitted that in barely two years, from October 1949 when the communist regime was established to 1951, the rampage of corruption, wastefulness, and bureaucratism has "developed to relatively serious proportions." The "three-anti" campaign exposed and punished a number of perpetrators.

A major case of economic crime prosecuted during the period was the celebrated corruption case of Tianjin party committee secretary Liu Qingshan and deputy secretary Zhang Zishan. Using political privileges and their responsible government positions, the duo of Liu and Zhang stole a total of 15.55 billion RMB yuan, by taking funds for building an airport, selling food intended for relief disaster-stricken people, exploiting and withholding back wages for civilian workers, and getting loans from a bank through fraud. In February 1952, the Provisional Court of the Hebei Provincial People's Court sentenced them to death.

Despite vigorous efforts during the "three-anti" period to fight graft, wastefulness, and bureaucracy, the struggle had only turned up several symbolic cases of crimes without getting at the root cause. More than 50 years later, the problem is still bothering the Chinese government with increasing inten-

sity, particularly economic offenses centered around organized and business crimes. It is extremely difficult to measure accurately how widespread white-collar and corporate crimes are in China, because statistical data has long been an instrument of political propaganda and manipulation, or not available at all. However, the limited official statistics do indicate the size of the challenge facing the authorities and how deep corruption has burrowed into the bureaucracy.

In the five years from 1997 to 2002, courts handled 118,692 cases of white-collar crime by public officials including embezzlement, bribery, and misappropriation of public funds. In that time, the courts handed down 118,482 sentences for offenses. Those sentenced by the courts included 19 provincial or ministerial-level officials, 318 department or bureau-level officials, and 2,031 county or office-level officials.

A major characteristic of white-collar and corporate crime in China is the gigantic web of government and party officials, corporate executives, and criminal organizations that work together in committing crimes. With the assistance of government and party officials, a number of business executives have stolen large sums of money from banks, state-owned businesses, state funds, and investors.

Business people, for their part, pay bribes to buy political protection for misdeeds, such as tax evasion or misappropriation of public assets. Bribes secure lucrative land deals, government contracts, rights to buy state enterprises at cut-rate prices, and even choice government and People's Congress positions. For businessmen, an official on the take is what Chinese call "a mountain to lean against." Business people know that if they have bought political backing, they can get investigations into their affairs called off and stories in the state media killed. The cases that are made public are the minority, in which an official or a businessman's political backing collapses. Sometimes that happens because the lawbreaking has gone so far that it threatens the political survival of a protector.

### CRIMINAL LAW

This important factor partly explains why white-collar and corporate crimes are increasing rapidly despite the Chinese penal system where relatively minor economic crimes can bring the death penalty. In China, most white-collar and corporate crimes

are listed under Chinese criminal law, which is primarily enforced by national, provincial, and municipal police departments. The people's protectorates are responsible for directly investigating crimes committed by party and government officials such as embezzlement, bribery, and dereliction of duty. However, not all cases of white-collar and corporate crimes go through criminal proceedings. Depending upon the nature of the case and the amount of money is involved, a number of white-collar crimes are dealt with by a wide variety of national, provincial, and municipal administrative laws.

In such a case, enforcement is the responsibility of administrative regulators who generally have fewer powers than police to detain suspects and search for evidence, and who normally impose a moderate fine on a culprit. Furthermore, probes of party officials who break the law begin with investigations by party discipline teams outside the criminal justice system.

The teams can choose to hand their targets on to judicial authorities for prosecution, or simply recommend a reprimand within the party. Many cases of white-collar crime committed by party officials, however, never reach the courts. In the years from 1992 to 1997, party discipline teams in China handled 670,100 cases of white-collar crime by party officials including embezzlement, bribery, and misappropriation of public funds, of which only about two percent ended with criminal punishment.

## INSIDER TRADING

One of the most sensational and widespread types of white-collar business crime in China involves trading stocks based on material non-public information, insider trading. Criminal law (article 180) deems illegal insider trading to be a criminal offense and establishes graduated penalties for insider trading based upon the amount of money involved, with maximum fines of 500 percent as high as the illegal proceeds, and the maximum jail term of 10 years for individuals in especially serious cases.

Although China has criminalized insider trading in a more severe way than many other countries by legislation, the enforcement has done little to eradicate what has become an entrenched feature of the Chinese securities market. To date there has been only one successful prosecution for insider trading, where Ye Huanbao, former chairman of

Shenzhen Real Estate Group, was given a three-year sentence and 800,000 RMB yuan fine, but was out on appeal in 2003.

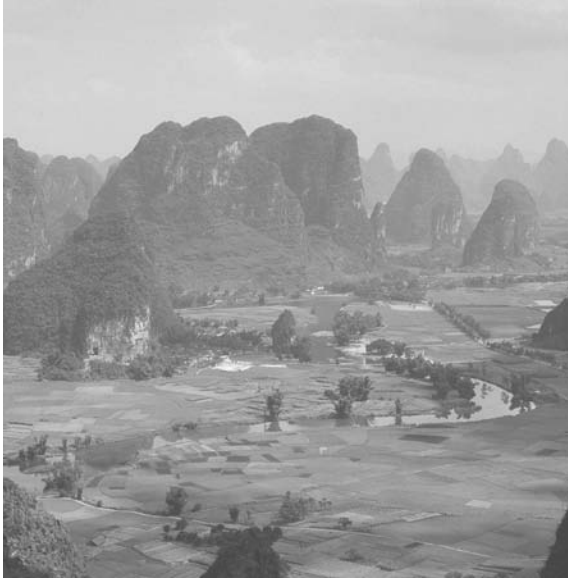
The Chinese Securities Regulatory Commission (CSRC) receives many more complaints than it can investigate, so it chooses only the most serious and significant for prosecution. Although the CSRC vowed to fight insider trading, only nine cases have been brought forward administratively under the insider trading provisions of the securities statutes since the first enactment of securities legislation in 1990. Of these, one accused was discharged for insider trading, one (a major corporation) was confiscated of the illegal gains, and seven accused individuals and corporations were fined by the CSRC amounts ranging from 50,000 RMB yuan to 2 million RMB yuan. Illegal insider trading can net the offending individuals and companies several million dollars per year in profits, so such fines are unlikely to be effective deterrents (1 yuan equals roughly 10 cents).

## ORGANIZED CRIME

As China opened its economy, organized business crime in China emerged from the special economic zones, and then extended to the hinterland areas. Criminal organizations continue in the 2000s taking shape along the southeast coastal areas and border provinces. Though most Chinese criminal organizations remain small, some in the bigger cities have become larger and more sophisticated with more members, a clearer command structure and, above all, political backing by corrupt officials.

One major characteristic of organized crime in China is the exchange of power and money. Some ringleaders move from the open to underground, and some infiltrate into the financial field under legal identity, as in the construction industry, stock transaction, and various trades. Chinese police sources indicate that criminal groups in inland China are beginning to be increasingly involved in business crimes, and are seeking to internationalize their operations.

One of the business crimes the criminal groups specialize in is smuggling. According to Chinese criminal law, smuggling is a criminal offense if more than 50,000 RMB yuan are involved, under articles 151 to 157, and especially serious cases of smuggling can bring the death penalty. There is little public evidence that the death penalty is effective in



*As China opened its economy, business crime moved from special economic zones to hinterland villages.*

combating smuggling and other business offenses. Moreover, enforcement is not frequent and consistent all the time. While there were some scapegoats sentenced to death for smuggling, a large number of such offenses (even if more than 50,000 RMB yuan are involved) are only subject to small administrative fines under the provisions of the customs law. There had been 253,000 smuggling cases investigated under the customs law from 1980 to 1990. Of these, only 3,516 cases (1.39 percent) were convicted by the court. The inconsistent enforcement and small fines are unlikely to effectively deter smugglers, compared to millions of dollars they can make in profits.

Like many other countries that have formulated provisions for the offense of money-laundering in their criminal laws, such provisions have been included in Chinese criminal law. Criminal punishment has been prescribed for money-laundering which is committed to cover-up or conceal the source and nature of the unlawful income or profits obtained from the obvious offenses of drug trafficking, offenses committed by organizations in the nature of criminal syndicate, or offenses of smuggling. There are some defects in China's laws relating to money-laundering. It is incomplete to define it only as drugs, criminal gangs, and smuggling, because a large part of the money-laundering cases in-

volve corrupt officials who channel capital to overseas countries. Inside sources say money-laundering on the Chinese mainland must be up to a yearly sum of RMB 200 billion RMB yuan, a figure equal to two percent of the nation's gross domestic product, or a near equivalent of US\$22.5 billion of the country's export earnings in 2001.

Other prevalent business crimes in China include fraud by bogus checks, deceptive contracts, taxation fraud, computer-related fraud, unsafe working conditions, fake trademark, fake medicine, fake food, and others. As the market-oriented economy takes hold in China, the last few years have seen white-collar offenders seeking loopholes in the legislation on economic development, and to exploit the imperfections in the market administration.

## CORPORATE CRIME LAWS

Besides the laws discussed above, a number of laws directed at white-collar and corporate crime have been made in recent years, including the Company Law (articles 206 to 228, preventing false statements at the time of application of an enterprise, commercial bribery and other corporate illegalities); the Commercial Banking Law (articles 73 to 86, preventing loan, investment and other banking frauds); the Insurance Law (articles 138 to 152, preventing insurance fraud); the Competition Law (preventing false advertising, fake trademarks, conspiracies and other unfair business practices); the Quality of Products Law (preventing the sale of harmful and dangerous items); the Tax Collection Law and the Personal Income Tax Law (preventing tax evasion); the Labor Law (ensuring that workers are not exploited); the Safe Production Law (protecting workers from unsafe working conditions); and the Environmental Protection Law. However, these laws are not always strictly enforced.

Authorities prefer persuasion behind closed doors first before the case is formally dealt with, and criminal sanctions as a last resort. Many corrupt officials interfere with legal proceedings of white-collar and corporate crime cases. When cases do go to court, offenders are much less likely to receive jail terms than street criminals. In the early 2000s, China intensified its crackdown on white-collar crime. The Chinese courts convicted nearly 90,000 people over five years on charges including embezzlement, fraud, tax evasion, counterfeiting—

a rise of more than 30 percent more over the previous five-year period. Noted officials who got tangled in the iron net of the law included former vice-chairman of the Ninth National People's Congress Standing Committee, Cheng Kejie (executed in 2000 for taking 41 million RMB yuan in bribes), former deputy governor of China's Jiangxi province, Hu Changqing (executed in 2000 for taking 5.4 million RMB yuan in bribes and possessing 1.6 million RMB yuan worth of property from unidentified sources), and former vice minister of the Ministry of Public Security, Li Jizhou (sentenced to death with a two-year suspension in 2001 for accepting more than 4 million RMB yuan in bribes in connection with the huge Xiamen smuggling case).

However, small fry made up most of the convictions. Since China established a unified anti-smuggling system in 1998, law enforcement departments and the Administration for Industry and Commerce have taken a major role in anti-smuggling. During the three years from 1999 through 2001, there had been 37,554 smuggling cases investigated by customs, involving 22.2 billion RMB yuan. During this time, 6,644 smugglers were administratively charged, 6,284 criminally prosecuted. It is not clear so far from these figures if this reform can control the prevalence and rise of white-collar and corporate crime in China.

#### SEE ALSO

Asia; corruption; bribery; embezzlement; capitalism; copyright infringement; trademark infringement; money laundering.

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## cigarette advertising

IN THE 1980s and 1990s, the duplicitous behavior of the tobacco industry increasingly attracted public criticism and was exposed in several trials and lawsuits. Vast sectors of the public opinion questioned the legality of smoking, and thus questioned its advertising: why should a deadly product be marketed as a pleasurable commodity? On the other hand, a considerable number of people felt that the demand for an increased regulation of smoking was an infringement on their freedom of choice. Bans on cigarette advertising, they claimed, conflicted with the 1st Amendment to the Constitution. The battle over tobacco products and their marketing rages on and, significantly, this debate has spread outside legal courts into popular culture, from the cartoon strips by G. B. Trudeau and the popular, Oscar-nominated film *The Insider* (1999), starring the actor Russell Crowe fighting against the beasts of the tobacco industry.

To those who argue for stricter regulation of the tobacco industry, cigarette advertising is synonymous with deceptive advertising, and thus with crime. Various sources have stressed that the tobacco industry's conduct has been extremely misleading. While all its internal papers and documents from the 1950s onward have acknowledged that smoking is addictive and that use of tobacco products causes cancer and death, the industry has adopted a range of advertising tactics which rejected its own findings. The aim of these campaigns has been to convince the public that there is still doubt about the harmful effects of tobacco or that the effects have been exaggerated.

In this way, argue those in favor of a ban on cigarettes and their advertising, the industry is simply trying to keep its profits, stop harsher government legislation and discourage lawsuits from patients suffering from supposedly tobacco-induced illnesses. An important collection of documents internal to the tobacco industry which would support this view is published under the collective name of *The Cigarette Papers* (1996).

The documents were originally sent to Professor Stanton Glantz at the University of California, San Francisco. The sender remained anonymous and only identified itself as Mr. Butts, the nightmarish character in Gary Trudeau's *Doonesbury* cartoon strip embodying Mike Doonesbury's sense of guilt for considering to work on cigarette advertising.

Although concerns about cigarettes and their advertising have become particularly prominent since the 1970s, the history of cigarette advertising has always been caught between the dichotomy of pleasure and danger. The first promotion scheme for cigarettes dates back to 1875 when producers Allen & Ginter introduced in their cigarette brands, Richmond Straight Cut No. 1 and Pet, picture cards to harden the pack and protect the cigarettes. The cards featured photos of actresses, baseball players, Native American chiefs, and boxers and were extremely popular.

Yet, even from these early times, smoking was a controversial issue. In 1898, Tennessee Supreme Court banned cigarettes, ruling that they were “not legitimate articles of commerce, being wholly noxious and deleterious to health” and indicting their use as “always harmful.” Washington, Iowa, Tennessee and North Dakota outlawed the sale of cigarettes in 1900. These concerns about how healthy smoking actually was reflected on advertising campaigns: the baseball player Honus Wagner ordered American Tobacco Company to take his picture off their Sweet Caporal cigarette packs, fearing it would lead children to smoke.

## EARLY ADVERTISING

The tobacco industry used advertising to appease these public concerns over possible health problems due to smoking. Cigarettes were marketed as giving extra protection against colds. From 1933 to the 1950s, the *Journal of the American Medical Association* regularly published cigarette advertisements. In addition, images of doctors would figure prominently on advertising and cigarette packets, in a striking contrast with the health warnings that would start to in the 1990s.

In 1953, the tobacco company Lorillard launched the Micronite filter, marketing it as a guarantee of “the greatest health protection in cigarette history.” Yet, this also turned out to be deceptive as it was discovered the filter was made of asbestos, and its use was discontinued four years after its promotion. In the later 1950s, the advertising strategies of cigarette producers changed: health issues were silenced to focus exclusively on flavor. These were the years in which, thanks to a successful marketing campaign, Marlboro started to occupy an increasingly large part of the market. Significantly, Marlboro’s advertising slogans (“Delivers the Goods on

Flavor,” “Come to where the flavor is. Come to Marlboro Country”) reflected the shift from health to taste benefits.

Some cigarette advertising campaigns have been addressed, implicitly or explicitly, to specific social groups. Women were heavily targeted in the first half of the 20th century and advertisements reassured them that there was nothing morally wrong in smoking. “Has smoking any more to do with a woman’s morals than has the color of her hair?” read a Marlboro slogan from the 1920s. More problematic have been campaigns addressed covertly to children. In 1987, Camel started to use Joe Camel, a cartoon character, in their advertisements.

Several researches showed that 91 percent of six-year-olds recognized Joe Camel, a similar percentage to those who recognized Mickey Mouse. In addition, thanks to the Joe Camel campaign, Camel’s share in the illegal market of minors increased dramatically in the late 1980s and early 1990s from 0.5 percent to 32.8 percent, worth more of \$400 million per year. Lawsuits were brought against the campaign, and the company finally dropped the character in 1997, although it never admitted that the Joe Camel ads targeted children and underage smokers.

Children and teenagers have constantly been targeted by the industry. Decades before Joe Camel, in the 1960s, the original run of television show *The Flintstones* was sponsored by a cigarette maker and the characters in the cartoon smoked Winstons at the end of each show. Tobacco advertising has always emphasized themes which appeal to youth: sexual attraction, social acceptance, thinness, and independence.

Cigarette companies have been skilful and cynical in avoiding bans on advertising their goods. For example, although cigarette advertising has been banned from American television since the early 1970s, sponsorship of televised sport events became the main strategy to avoid the prohibition to broadcast TV ads. It was estimated that during the 93 minutes of the 1989 Marlboro Grand Prix, the name Marlboro appeared 5,933 times for a total of 46 minutes.

In spite of lawsuits and bans, cigarette producers are still managing to reach a wide range of customers with their messages which market flavor and “coolness.” Yet, advertising has also started to backfire at the industry: two of the actors who played the famous Marlboro Man in the company’s adver-

tising campaign, Wayne McLaren and David McLean, died of lung cancer in the 1990s. Before his death, McLaren asked at a meeting of Philip Morris shareholders that tobacco producers agree to limit their advertising.

#### SEE ALSO

tobacco industry; advertising fraud; consumer deaths; puffery.

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## civil forfeiture

BEGINNING IN EARLY 1980s, governments and law enforcement agencies in the United States and abroad placed ever-increasing emphasis on targeting the fruits of organized criminal activity. The culmination of this enforcement approach is the seizure and forfeiture of money and other assets derived from criminal activity.

An underlying tenet of proceeds of crime enforcement as a punitive strategy is that the resulting penalties not only encompass the forfeiture of cash and other assets, but fines and criminal sentences may also ensue. An added benefit of this enforcement approach is that it can remove the financial power base that funds the operations of criminal organizations.

In most countries, asset forfeiture is pursued through the criminal courts. For a conviction, coun-

tries relying on the English common law systems require proof beyond a reasonable doubt, which often translates into a heavy burden for prosecutors, especially in relation to criminal entrepreneurs who have successfully concealed ownership of assets. In response, a select few governments have enacted legislation that provides the state with the tools to undertake civil action against individuals and entities involved in organized criminal activity. This includes civil-forfeiture laws, which provide the government with the power to seize property through civil, rather than criminal courts.

Because forfeiture is now pursued through the civil courts, the burden of proof placed on the state is reduced from "beyond a reasonable doubt" to a "balance of probabilities." In other words, governments can confiscate money or assets where only a "reasonable suspicion" may exist that the cash or assets constitute the proceeds of crime. The onus of proof is now shared between the state and the defendant; that is, unlike a criminal trial where there is no obligation by the defendant to prove his innocence, in a civil-forfeiture process the defendant must often prove that the assets in question were derived through legal and legitimate means.

The application of civil sanctions against organized and economic crimes has been most vigorously (and controversially) applied in the United States. The federal Racketeer Influenced Corrupt Organization (RICO) Act makes it unlawful to acquire, operate, or receive income from an enterprise through criminal means. RICO allows the government or a private citizen to file a civil suit requesting the court to order sanctions, or to provide injunctive relief against an individual or organization involved in a "pattern of racketeering." Civil RICO injunctions can, for example, prohibit individuals from owning or becoming involved in certain legitimate or illegitimate businesses or activities.

RICO also allows for the state or private victims to sue civilly to recoup "treble" damages (that is, the defendant must pay to the plaintiff three times the amount of damages that have been determined by a court). A criminal conviction is not a prerequisite for injunctive relief or asset forfeiture under RICO and no person need be charged; the civil asset forfeiture provisions of RICO focuses on property, not people.

The application of civil injunctions, treble damages, and civil asset-forfeiture against criminal organizations and offenders under the RICO statute

have proven successful in the United States in their impact on various organized crime groups. However, many have argued that the law has overstepped its original purpose and has been abused by both justice officials and private citizens. As a result, federal and state officials have taken steps to curtail the far-reaching powers of RICO, including shifting the burden of proof back on to the state and ensuring due process is preserved for defendants.

#### SEE ALSO

Racketeer Influenced Corrupt Organizations (RICO) Act; prosecution.

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## class-action lawsuits

A CLASS-ACTION LAWSUIT generally results when someone involved in a lawsuit against a particular company or group realizes that others are involved in similar cases. The major parties in a class-action lawsuit are the plaintiffs, the lawyers, the defendant(s), expert witnesses, and court officials. In class-action lawsuits, lawyers tend to be either idealists who believe in a cause, or ambitious professionals who smell big money. Payment to attorneys may be a percentage of the award or a separate amount established by judges who hear the cases. If a lawyer is dedicated to the case for whatever reason, she may even put up personal funds to finance the early stages of a lawsuit.

Most class-action lawsuits derive from intentional sales of products that can cause harm to users. The goal of the manufacturer is usually to amass huge profits, while the consumer is interested in products that are both safe and effective. In the early stages of a class-action lawsuit, the sides may be unevenly matched because a single lawyer for injured clients may go up against a team of corporate lawyers who represent the manufacturer. As more

people come into the class-action lawsuit, the stakes become higher, and more lawyers may be brought on board.

In order for a lawsuit to be certified as class action, it must be proved that large numbers of plaintiffs have been affected and that the relevant damage occurred under the same circumstances. Once extensive claims have been established, it is assumed that it is more efficient to handle the cases together than to respond to claims that may be scattered among a number of separate jurisdictions or which might result in conflicting judgments. Time may also be a factor for seriously ill claimants, and class-action lawsuits tend to move through the courts more rapidly than do individual cases.

Amendments to the Federal Rules of Civil Procedure in 1966 established three mandatory classes and one voluntary class in class-action lawsuits. The mandatory classes include cases where: 1) separate actions might result in incompatible standards; 2) separate actions might be detrimental to the interests of the claimants; and 3) it is necessary to prevent piecemeal and/or contradictory remedies. Multi-district litigation (MDL) was set up to transfer a large number of geographically separated claimants to a single district. For example, victims or survivors of airplane crashes or hotel fires might be handled through MDL. The first three classes of lawsuits are mandatory and require that individual plaintiffs be bound by resulting judgments. The fourth class is optional, allowing an individual to opt of the class action.

Due to the enormous amount of media attention that has focused on a number of high-profile class-action lawsuits, such as those involving asbestos, Bendectin, the Dalkon Shield, and Agent Orange, consumers and unwitting victims have become more aware that joining forces with other plaintiffs gives a case more impact and increases the chance of proving manufacturer liability. Plaintiffs have also attempted to mandate government and/or manufacturer accountability through class-action lawsuits involving dioxin, nuclear waste disposal, and toxic landfills.

### ASBESTOS

In 1961, the first case charging that exposure to asbestos could cause cancer was filed in Orange, Texas. Claude J. Tomplait who had been an asbestos insulator for some 20 years sought legal help in fil-



ing for worker's compensation. Tomplait had been experiencing severe shortness of breath and "finger chubbing," a thickening of the tissue at the fingertips, for two years and had tentatively been diagnosed with pulmonary dust disease and was unable to work. Both symptoms had previously been associated with exposure to asbestos. In fact, adverse reactions to asbestos could be traced as far back as 1900 when an autopsy was performed after the 10th worker of a 10-man carding room team in an asbestos textile mill died. Within the next few years, settlements in asbestos cases reached up to \$20 million for 445 foam workers in Tyler, Texas and as much as \$3 million in an individual case in Beaumont, Texas.

The U.S. government estimated that at least 11.5 million American workers had been exposed to asbestos. The number of suits over asbestos-related damage against the Manville Corporation, the largest asbestos manufacturer in the world, had grown to such an extent by August 1982 that the company filed for Chapter 11 bankruptcy. Even schoolchildren were not exempt from exposure to asbestos. School-asbestos litigation in 1986 involved a nationwide class-action lawsuit resulting from a number of lawsuits around the country directed toward deciding who was responsible for removing potentially damaging asbestos insulation from public schools.

## BENDECTIN

One of the major class-action lawsuits against a drug company involved the drug doxylamine succinate or Bendectin, which was given to pregnant women experiencing nausea and vomiting. The manufacturer, Merrell-National Laboratories of Cincinnati, Ohio, had identified such adverse side effects as drowsiness, vertigo, nervousness, epigastric pain, headaches, palpitations, diarrhea, disorientation, and irritability. The drug was removed from the market in 1983 as a result of class-action lawsuits claiming that Bendectin caused birth defects. For example, a Florida woman who reported that her son was born with a sunken chest and hand deformation was awarded \$20,000 for medical expenses.

As the lawsuits progressed, lawyers for the manufacturer pursued an aggressive and successful strategy of attacking medical experts and convincing the courts of the company's innocence. By December

1997, the case against Merrell was virtually over, and most claimants had failed to prove Bendectin had been responsible for birth defects.

## DALKON SHIELD

In 1972, the first suit was filed in response to injuries suffered by wearers of the Dalkon Shield, an intrauterine device (IUD) manufactured by A. H. Robins. By 1985, over 14,000 lawsuits had been filed by American women who had worn the birth-control device. In August 1985, a team of four attorneys in Minnesota, representing around 2,000 plaintiffs, filed a class-action lawsuit on behalf of all Dalkon Shield claimants. Millions of Dalkon Shields had also been distributed across 80 other countries, many to women in developing countries with inadequate access to medical services. A. H. Robins, as might have been expected, filed for bankruptcy. Evidence presented in the course of the Dalkon Shield suits revealed that Robins had knowingly sold the IUDs despite evidence that the copper in the product could cause damage, and that their own tests had indicated a potentially dangerous problem with "wicking" in the string attached to the shield. Damages suffered by the women included maternal and fetal deaths, birth defects, "spontaneous abortions," infertility, and a host of lesser complaints. The final settlement against Robins and Aetna (Robins's insurance company) involved \$2.375 billion to be paid in installments.

## AGENT ORANGE (DIOXIN)

Defendants in class-action lawsuits are not always manufacturers. Charges were leveled against the U.S. government, as well as against the manufacturers of dioxin, in the Agent Orange class-action lawsuit where the legality of the issues became interwoven with political and scientific arguments. Veterans developed flu-like symptoms, rashes, joint pain, headache, and other such feelings of general malaise. In more serious cases, it was assumed that cancer and birth defects among babies born to Vietnam and Gulf War veterans were connected to exposure to Agent Orange.

Initially, judges in the United States concluded that scientific and medical evidence linking Agent Orange to the symptoms experienced by veterans was unclear and legally invalid. Affected veterans claimed that the government was responsible for

medical care and compensation and also wanted to hold the manufacturer accountable. Plaintiffs argued that damage caused by exposure to Agent Orange had been identified as far back as the 1970s. For example, Paul Reutershan, a helicopter pilot who had transported supplies through clouds of herbicides, had contracted cancer of the colon and liver. He sued Dow Chemical. In May 1984, Vietnam veterans agreed to a settlement offered by lawyers of seven chemical companies.

While lawyers for the veterans had put up \$750,000 of their own money to pursue the case, the judge limited the total legal fees to under \$10 million. The total settlement for the veterans was approximately \$180 million to be divided among 10,000 current plaintiffs and others who joined the suit within the next year. By 1985, the number of plaintiffs involved in the suit had swelled to 200,000, including affected veterans and widows and orphans of those who had died. The Agent Orange Class Assistance Fund was established to provide counseling and services to veterans and survivors not eligible for cash awards.

Charges were also made from 1991 to 1996 that the federal government had knowingly exposed military personnel in the Gulf War to radiation. Although the government insisted it was innocent and claimed that the symptoms were related to stress, evidence released in 1996 revealed that up to 20,000 troops had indeed been exposed to Agent Orange when army engineers detonated munitions bunkers



*Vietnam War veterans have filed class-action lawsuits over being exposed to Agent Orange, used to defoliate jungles.*

stored in Khamisiyah in Iraq. Subsequent reports suggested that the fallout from the explosions could have affected hundreds of thousands of troops located in the surrounding area. Both the Department of Defense (DOD) and the Central Intelligence Agency (CIA) admitted that they had been aware of the presence of chemical weapons in the Iraqi location for several years.

## SEXUAL HARASSMENT

Class-action lawsuits may also include only a small number of people and have nothing to do with product liability. In 1975, the Forbes Fairlaine Plant, owned by the Evalth Mines, hired a small number of female workers to work in the previously all-male plant. Over the next few years, the female workers were subjected to an intense campaign of sexual harassment, and male supervisors turned a blind eye to the behavior. Additionally, the women were passed over for promotions. In 1988, Louise Jensen, Patricia Kosmach, and Kathleen O'Brien Anderson filed suit against Evalth for alleged sexual harassment and sexual discrimination. All three women suffered from either severe medical or stress-related illnesses. The case, certified as a class-action lawsuit four months later, included all female employees who had worked for Evalth Mines since 1983. In 1986, the Supreme Court decision in *Meritor Savings Bank v. Vinson*, held that employers were responsible for providing a nonhostile working environment.

During the Evalth trial, the court refused to provide an injunction to ban the behavior in question, so the harassment accelerated during this period. During the course of depositions and testimony, it became clear that male employees of Evalth had engaged in a concentrated campaign of sexual harassment that included derisive remarks, inappropriate physical contact, and sexually explicit graffiti and jokes. The landmark decision, which found Evalth liable, received nationwide coverage. The eventual settlement provided \$3.5 million in damages for the 15 women included in the suit.

## SEE ALSO

asbestos; A. H. Robins; Dalkon Shield; Bendectin; war crimes; sexual harassment.

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## Clayton Antitrust Act

PASSED BY THE U.S. CONGRESS in 1914, the Clayton Antitrust Act supplemented and strengthened the Sherman Antitrust Act of 1890. Addressing specific anti-competition practices and problems within the Sherman Act, the Clayton Act's clarifications allowed the federal government to better deal with companies which had monopolies over certain U.S. industries.

The Sherman Act's powers were utilized heavily during the presidencies of Theodore Roosevelt and William Taft in the early 1900s. The act prohibited any action by private firms that would avoid or prevent the natural regulatory action of the U.S. market system. It worked to encourage a healthy and decentralized market structure based upon industry rivalries and competition.

Authorized by the Sherman Antitrust Act in order to maintain competition, the U.S. attorney general is permitted to bring lawsuits against companies that have monopolistic characteristics and attempt to dominate the market in a non-competitive manner. Other companies or parties can bring suit against monopolistic companies as well, and may receive compensation from violators of the Sherman Act. However, the Sherman Act had proved to be relatively unsuccessful in preventing large com-

panies from dominating their industries, especially after the Roosevelt and Taft presidential terms. Vague language plagued the Sherman Act, allowing lawyers for the powerful companies to find a number of loopholes in the legislation. Consequently, the Act's language could be interpreted in different ways.

For example, lengthy disputes revolved around the interpretation of the differences between monopolizing, which was banned by the Sherman Act, and the existence of a monopoly, which is not banned explicitly in the act. As a result, these companies were still able to enter into restrictive business agreements that were not outlawed by legislation or precedent, continuing to create massive concentrations of wealth. The companies' massive treasuries allowed them to dominate their industries, to buy out other smaller companies, and to have the resources necessary to fight the federal government and its antitrust legislation.

### IMPROVING THE SHERMAN ACT

Originally drafted by U.S. Representative Henry De Lamar Clayton from Alabama, the Clayton Act was passed by the U.S. Congress to ameliorate the problems caused by the ineffective Sherman Act. Attacking specific business practices which were highly conducive to the establishment of a monopoly, the Clayton Act had extensive definitions and clearer language when dealing with different actions by private firms.

Outlawed actions include the formation of a trust between two companies with a combined board of directors and access to more than \$1 million in capital, price-fixing agreements with another company that is offering a competing product, agreements that result in an ability to control supply of resources or products which leads to higher prices, and the use of power in a particular industry in order to gain or maintain a monopoly. These specifics prevented companies from price-cutting only in certain areas to attack competition that cannot match the price cut, and from merging to combine market share in a monopolizing fashion.

Labor unions and agricultural cooperatives were excluded from antitrust action by the Clayton Act, trying to deter large companies from exploiting their workforce. Also, the act attempted to restrict the use of federal injunctions against striking laborers, promoting peaceful strikes, picketing, and

boycotting. Labor unions were initially hopeful about the act, but following later judicial decisions, precedents damaged the act's labor provisions.

The Clayton Act's provisions were utilized often in lawsuits brought against large companies. Soon after the passage of the Clayton Act, the U.S. Congress enacted the Federal Trade Commission Act of 1914, creating the Federal Trade Commission (FTC) to enforce antitrust legislation, among other tasks. In 1920, federal prosecutors from the FTC failed to use the Sherman Act and the Clayton Act effectively and the famous U.S. Steel monopoly case ended in failure.

The Supreme Court ruled that "the law does not make the mere size an offense or the existence of un-exerted power an offense." Similar to the Sherman Act, the Clayton Act was later strengthened by amendments. The Robinson-Patman Act of 1936 further detailed price discrimination and the Celler-Kefauver Act of 1950 prevented mergers by dealing with intercorporate stock holdings.

#### SEE ALSO

antitrust; Sherman Antitrust Act; Federal Trade Commission; Robinson-Patman Act; Celler-Kefauver Act.

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## Clean Air Act

IN RESPONSE TO GROWING concern for the quality of the environment, the Clean Air Act (CAA), first passed in 1970 and amended substantially in 1990, has grown from its original set of guidelines for states to regulate sources of air pollution to specific air-quality requirements and regulatory programs.

Authorized by the CAA of 1970, the Environmental Protection Agency (EPA) established the National Ambient Air Quality Standards (NAAQS), which was the traditional centerpiece of CAA regu-

lations. The NAAQS addresses six pollutants that threaten public health and welfare: sulfur dioxide, nitrogen oxides, particulate matter, carbon monoxide, ozone, and lead. All states and cities and towns in the United States must have levels of these pollutants beneath the ceilings required by the NAAQS or face substantial "nonattainment" fines and penalties.

The CAA authorized the establishment of New Source Performance Standards (NSPS), which regulates the amount of permissible emissions from different classes of facilities. The NSPS requirements are set at levels that are attainable by using programs and systems of emissions reduction, while taking cost for businesses into consideration. However, the NSPS' primary concerns are air quality, environmental impact, and energy requirements, not cost.

The National Emissions Standards for Hazardous Air Pollutants (NESHAP) is another major component of the CAA. It was created to detail and regulate pollutants that may result, or are anticipated to result, in a decrease in public health. So far, this list of potentially harmful air pollutants contains 189 hazardous substances. The 1990 CAA amendments required the EPA to set standard, permissible ceilings for the substances. The implementation of risk-management programs at businesses for dealing with potential releases of hazardous substances is also one of the new requirements of the 1990 CAA amendments.

The CAA amendments administered a specific system for acid rain, caused by sulfur dioxide emissions, describing a potential reduction of 10 million tons annually. The new system, which is market-based, provides power plants, or other sulfur dioxide producers, with emissions allowances, which may be bought, sold, or traded with other companies. Other similar operating permit programs that regulate various air pollutants have been established, administered by state governments. These permits deal primarily with the construction of new businesses or sources of air pollution.

The CAA amendments also set requirements for the banning of chlorofluorocarbons (CFCs) and halons to stop the depletion of the Earth's ozone layer and to comply with the Montréal Protocol, which set international guidelines to reduce depletion.. Fines may be levied against those individuals or businesses that do not meet CAA standards. The CAA amendments legislated criminal penalties and potential jail time of up to 15 years for those who

knowingly violated CAA standards, along with fines of up to \$250,000 for individuals and \$500,000 for corporations for each violation. Since November 15, 1990, when President George H. W. Bush signed the CAA amendments into law, the CAA has had far-reaching positive effects on public health and the environment.

#### SEE ALSO

Environmental Protection Agency; air pollution; water pollution.

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## Clean Water Act

IN RESPONSE TO increasing public concern for the environment and for the condition of the nation's waters, the U.S. Congress enacted the Federal Water Pollution Control Act Amendments of 1972, revising previous ineffective legislation. Amended once again in 1977, Congress refused to allow continued unregulated discharges of untreated wastewater from municipalities, industries, and business into rivers, lakes, and coastal waters of the United States. The law became more commonly known as the Clean Water Act (CWA), and provided a plan to restore and maintain clean and healthy waters.

The CWA can be broken down into five main elements: minimum standards for waste discharges for each industry, standards for water quality, a permit program with enforceable discharge limits, regulations for specific problems like toxic chemicals and oil spills, and a loan program for the construction and modernization of publicly owned treatment plants.

Since its enactment, the CWA's greatest concern has been control of point-source pollution, which is discharged by sewers and factories. The minimum standards for waste discharges are regulated by the Environmental Protection Agency

(EPA) and the standards result in waters which are better for the overall environment and public health.

The discharge permit program, known as the National Pollutant Discharge System (NPDES), is another way that the CWA regulates point-source pollution. The program requires any wastewater treatment plant to obtain discharge permits and follow EPA guidelines for water treatment.

More than 16,000 wastewater plants are part of the permit program and around 3,000 of those plants, mostly publicly owned, participate in the National Pretreatment Program. Pretreatment, designed to reduce the number of pollutants discharged into the sewer system by non-domestic sources, results in safer plant operation and wastewater and sludge which are able to be reused or recycled.

As a result of the CWA, many municipalities across the U.S. have received federal funds to build and to improve wastewater treatment plants. Revisions to the CWA in 1987 removed the previous construction grant program and replaced it with a streamlined State Water Pollution Control Revolving Fund, which built upon the EPA's relationships with each state.

Since its enactment, the CWA has been amended numerous times in order to deal with specific environmental issues like wetlands protection or Great Lakes water quality. As a result of the EPA's enforcement of the CWA and its strong regulations and revisions, significant strides have been made, leading to improvement of public health and the environment. However, challenges remain to be overcome; problems mostly arising from non-point sources like combined and sanitary sewer overflows, continued water treatment infrastructure improvements, and municipal sewage sludge use and disposal.

#### SEE ALSO

water pollution; Environmental Protection Agency.

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## Clinard, Marshall (1911–)

MARSHALL BARRON CLINARD is an emeritus professor of sociology at the University of Wisconsin, Madison. Clinard's early education was at Stanford University, and his doctoral training occurred at the famous Chicago School, officially known as the department of sociology at the University of Chicago, where he received his Ph.D. in sociology in 1941. A highly distinguished scholar in the discipline of sociology and the subfield of criminology, Clinard has held academic positions in several universities, including the university of Iowa and Wisconsin, and Vanderbilt University.

In the course of his long and prominent career, Clinard has authored or co-written more than 10 books, 40 articles, and 25 book chapters. His awards are numerous, and he has been honored by many of the leading academic and professional organizations in sociology, criminology and white-collar crime. These include the Academy of Criminal Justice Sciences, the American Society of Criminology, the American Sociological Association, and the Association of Certified Fraud Examiners. Clinard is known for his research in areas that include the sociology of deviant behavior, corporate crime, as well as gang formation and control.

Clinard was one of the first criminologists to follow Edwin Sutherland's early white-collar crime research. In his 1952 study of black-market offenses during World War II, Clinard examined whether these forms of behavior should be considered white-collar crime. He challenged Sutherland's differential association theory by arguing that the personality characteristics of black-market offenders were equally likely to explain their behaviors. Following the 1952 study, Clinard made significant and longstanding contributions to the study of white-collar and corporate crime through his research with critical theorist Richard Quinney.

Their efforts at resolving ongoing definitional disputes resulted in the widely accepted division of white-collar crime into two distinct forms: corporate crime, which occurs on behalf of a corporation and benefits the corporation, and occupational crime, which is committed by individuals against their employing organizations, and benefits the individual offender.

This typology clearly articulated the appropriate unit of analysis for white-collar crime research: either the corporation, or the individual. As a re-



*Clinard's research into the corporate suites of America revealed companies violate the law with great frequency.*

sult, additional white-collar crime research focused on either corporate crime or occupational crime. This did not solve the definitional debates, but at least added conceptual clarity to the field.

A subsequent research contribution made by Clinard resulted from his collaboration with Peter Cleary Yeager on a study that was published in two forms: 1979's *Illegal Corporate Behavior* and 1980's *Corporate Crime*. In the Sutherland tradition, Clinard and Yeager examined crimes committed by the 477 largest manufacturing corporations and the 105 largest wholesale, retail, and service corporations in the United States in the years 1975 and 1976. In that two-year time frame, these 582 corporations were the target of 1,553 federal cases.

The implications of the study were staggering: due to the fact that the numbers were based only on cases brought against the corporations, they underestimated the true, total amount of corporate crime. To use the authors' terms, the findings were merely "the tip of the iceberg." The results confirmed Sutherland's principal finding: corporations violate the law with great frequency. Nearly a quarter of a century after these studies, the results provide a valuable context for researchers examining corporate crime.

SEE ALSO

Sutherland, Edwin H.; differential association; self-control theory.

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## Clinton, William J. (1946–)

THE PRESIDENCY of Bill Clinton, which presidential history scholars have called “puzzling” and “bizarre,” will go down in American history as unique in a number of ways. Before Clinton took office, it was taken for granted that 20th-century presidents would have served in the military. Not only had Clinton failed to serve in the military, he had actually avoided the draft. Supporters of Republican candidate George H. W. Bush (1924– ) hired airplanes to hover over Clinton campaign rallies displaying banners suggesting that voters should not vote for a “draft dodger.”

While Clinton campaigners were generally aggressive, they neglected to put the Republican accusation in the context of widespread distaste for military duty as the Vietnam War became more and more unpopular. Clinton was also criticized for smoking marijuana as a college student, and few people believed him when he insisted that he had not inhaled.

During the honeymoon period enjoyed by most presidents, Clinton tried to fulfill a campaign promise by ending discrimination against gays in the military. In response to a public outcry and outrage in the military, the president settled for a “don’t-ask-don’t-tell” policy that begged the question.

Scandal haunted the Clinton presidency; yet, he survived Whitewater, Travelgate, Nannygate, Troopergate, the suicide of a close adviser, only to become the second president in history to be impeached by the House of Representatives. Like Andrew Johnson (1808–75), Clinton was not removed from office by the Senate. Unlike Johnson, Clinton retained the approval of many Americans throughout the impeachment process. During this period,

Clinton’s job approval rating hovered at 70 percent. Clinton’s popularity during the impeachment proceedings is even more remarkable when compared with Ronald Reagan’s 40 percent approval rating during the Iran-Contra scandal. Known as the “Comeback Kid,” Clinton was a survivor, and the American people were more interested in the booming economy that had led the country out of recession than in political scandals.

During the Clinton administration, white-collar crime flourished in both the public and private sectors. Attorney General Janet Reno, the first woman to hold that office, was involved in investigating campaign illegalities in both the presidential and vice-presidential campaigns, in addition to investigating Clinton’s involvement in Whitewater and several sex scandals. Reno also went after companies that violated antitrust laws such as Microsoft and put pressure on federal lawmakers to bring an end to securities fraud and insider trading. She effected a major overhaul within the Justice Department, promoting governmental ethics by appointing ethics advisers to serve in the offices of all U.S. attorneys.

### TRAVELGATE

When Hillary Clinton announced plans to fire seven veteran members of the White House travel office, including director Billy Dale, and replace them with a private firm, Republicans called it a scandal and dubbed it “Travelgate.” The Clinton administration was accused of improperly using the Federal Bureau of Investigation (FBI) and the Internal Revenue Service (IRS) to support erroneous charges against the former employees. All seven were later cleared of wrongdoing, but the scandal continued to haunt Hillary Clinton when she ran for Senator from New York in 2000. Independent Counsel Robert Ray announced that the First Lady’s testimony was “factually false,” but determined that he lacked sufficient evidence to ask for an indictment.

### NANNYGATE

The Nannygate scandal occurred when Clinton nominated Zoe Baird as the first female attorney general of the United States. Baird was forced to withdraw from consideration when it became known that she had violated federal law by hiring

illegal immigrants as nannies and paying them off the books. Clinton's second candidate Kimba Wood suffered a similar fate. Clinton then nominated Reno who had never been married and who had no children and so avoided the possibility of other childcare scandals.

## WHITEWATER

While Clinton was governor of Arkansas, he and Hillary invested in a development deal to build a resort on the White River in Arkansas with their friends James and Linda McDougal. The Clintons' part of the deal was financed through a \$20,000 loan from the Union National Bank of Arkansas. James McDougal was the head of the Madison Guaranty Savings and Loan, which collapsed in 1989. Both James and Susan McDougal were convicted of conspiracy and mail fraud and were sent to jail, where James McDougal died in 1998. During the course of the investigation into Madison, federal investigators discovered that the Clintons had been considered equal partners in Whitewater Development despite the fact that the McDougals had put up most of the money and that the Clintons had continued to receive money from the deal even after Madison collapsed. Bill and Hillary Clinton, however, insisted that they lost money on the deal. Republican Kenneth Starr was appointed to investigate the Clintons' connection to Whitewater and spent several years and millions of taxpayer dollars attempting to prove that the Clintons had acted unethically.

## SEX SCANDALS

As a Democratic candidate for president, Clinton had been accused by a supermarket tabloid of having a long-term affair with Gennifer Flowers, a lounge singer from Arkansas. Clinton survived this first sex scandal with his wife's help. The two appeared on national television to publicly answer the charges and prove that their marriage was strong. The Flowers fiasco was followed by what became known as "Troopergate" in which two Arkansas state police officers announced that they had helped Clinton to have a number of affairs while he was governor of Arkansas, and suggested that Hillary Clinton had also had affairs. The troopers later admitted that they had lied and revealed that the scandal had been funded by a right-wing billionaire from

Arkansas. Clinton was then sued by Paula Jones for sexual harassment. Trooper Danny Ferguson who had supposedly set up the liaison between Clinton and Jones insisted that Jones had emerged smiling from the encounter with Clinton. Independent Counsel Starr who was investigating the Whitewater affair added Jones' allegations to his investigation. Even though it was revealed that Jones was encouraged and financed by conservatives interested in bringing down the president, Starr pursued the investigation with gusto. Clinton claimed that as a sitting president, he should not have to face charges, but the conservative-dominated Supreme Court disagreed with him.

Clinton's downfall in the sex scandals proved to be a former White House intern named Monica Lewinsky with whom Clinton had sexual contact, although the President insisted it was "not really sex." Lewinsky admitted that the relationship had been consensual and said she had never planned to make the affair public. Lewinsky had been secretly taped by a conservative "friend" Linda Tripp who was convinced she could use the information to bring down the president. Lewinsky agreed to work with Starr only after becoming a target of his pressure tactics. Lewinsky received a major makeover and became a minor celebrity.

## IMPEACHMENT

After it was revealed that Clinton lied under oath in his Paula Jones testimony, the House of Representative impeached him on charges that he had lied under oath and that he had acted to obstruct justice. Public opinion polls revealed that most Americans believed that Clinton should be punished by some means other than impeachment. During the proceedings, for the first time in American history, a president of the United States talked about his sex life on national television. After surviving the unsuccessful attempt to remove him from office, Clinton returned to the White House jubilant and rejuvenated. On the other hand, the reputations of Republicans and the media suffered a temporary ethical setback of their own.

## ELEVENTH-HOUR PARDONS

Clinton's final scandal concerned his last minute pardon of 140 individuals only two hours before leaving office. He was particularly criticized by the

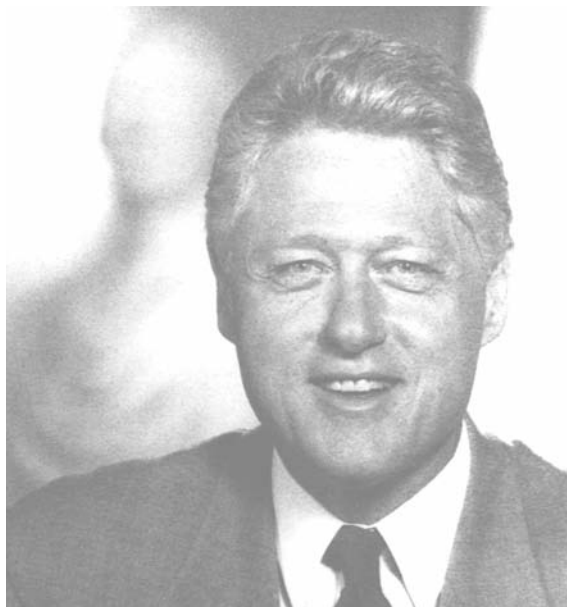


far right who accused him of abusing his office by selling pardons. Last-minute presidential pardons are not unusual. However, Clinton's wisdom in issuing the pardons was questionable because he had personal ties to at least three of those whom he pardoned. Clinton's high-profile pardons included Henry Cisneros, the former HUD Secretary who resigned from office after it was discovered that he had lied to the FBI during a background investigation about how much he had paid his mistress, and Patty Hearst, the heiress who had been found guilty of a bank robbery that occurred while she was being held by the Symbionese Liberation Army. The president's half-brother Roger was pardoned for a 1985 drug conviction, and Susan McDougal was pardoned for her part in the Whitewater scandal.

Clinton's approval of a pardon for indicted fugitive financier Marc Rich was very controversial. Rich's involvement with highly suspect business deals brought him to the attention of the U.S. federal government, and in the early 1980s, he was indicted for income tax fraud and breaking a U.S. embargo by selling oil to Iran during the hostage crisis. A criminal indictment was filed against Rich and his partner, Pincus Green, by U.S. Attorney Rudolph Giuliani in 1983. Rich and Green, however, fled the country for Switzerland before the pair could be brought to court to answer the charges. Both Rich and Green remained on the Most Wanted list of the Justice Department for 18 years.

That is, until January 20, 2001. A few hours before leaving office, Clinton fully pardoned Rich and Green, thereby nullifying the indictment against them. The presidential pardon was controversial because Rich had a long history of questionable transactions with third world nations and because Denise Rich, Rich's ex-wife, had lobbied hard for the pardon. The lobbying effort included donations of \$70,000 to Hillary Clinton's Senate campaign, several hundred thousand dollars to the Democratic Party, and \$450,000 to Clinton's presidential library. Clinton denied any connection between the lavish contributions and his decision to pardon Rich and Green. The U.S. Senate Judiciary Committee held hearings to review the legality of the pardon in February 14, 2001 but the results were inconclusive.

While Clinton's job approval ratings continued to be high during most of his presidency, most Americans, whether they were Republicans or De-



*Bill Clinton's legacy as president includes a vibrant economy but also perjury and impeachment.*

mocrats, were appalled by his personal morals and his lack of judgment in giving his enemies the ammunition they needed to begin impeachment proceedings. After leaving office, the former president took a back seat to his wife, a newly elected New York Senator.

#### SEE ALSO

Whitewater; United States; ethics; Rich, Marc.

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## coal mining

COAL MINING companies have a long history of crimes against employees, and the state and federal government, that dates to the 19th century. Crimes against employees included illegal cheating in coal weights, excessive hours, the company towns’ gouging and scrip, unsafe working conditions, and government-assisted violence. Crimes against the United States came later and included violations of labor laws, safety laws, and environmental laws.

The coal regions in the 19th century tended to be remote, tied to the market by the railroads that were the prime consumers of coal. As the United States industrialized between 1880 and 1930, the mining companies entered regions occupied by self-sufficient farmers and enticed the farmers to the mines and the company towns.

Companies built towns, including churches, services, and shops for their mine employees. Miners could rent as long as they were employed, but if they were on strike or otherwise off the payroll they could expect eviction with a 5-day notice. The miners received at least part of their pay in scrip redeemable at the company store. Miners complained about unsanitary conditions, restrictions on their lives, and higher prices in the company stores. Miners sometimes had no right to bring non-employees into company housing, and companies could ban independent stores and peddlers. Company police patrolled the towns and the roads. Company towns largely disappeared by the 1920s.

Companies neglected safety in the mines and cheated on coal weights. Companies influenced state governments to allow convict labor in the mines, even to the point of creating mines within the prison system. Convicts were a controlled labor source that allowed owners to depress wages, repress unions, and break strikes. Sympathetic judges commonly issued injunctions against organized

labor, and the owners influenced state governments to call out the militia to crush unionist disturbances. Companies spied on workers and established their own armies. The Pinkerton agency was the most prominent of the company armed forces. Baldwin-Felts guards enforced owners’ law in West Virginia, Kentucky, and Colorado early in the 20th century.

In one state, West Virginia, absentee ownership became the rule after the Civil War as outsiders bought control of timber, coal, oil, and gas rights. They spent money, they brought jobs, and they created a political system that looked out for their interests. The cost was the people’s life and limb, education, and dilapidated infrastructure because of the inadequate tax base and inadequate enforcement of tax collection. Between 1883 and 1969, 21,311 miners died on the job in West Virginia. When the miners asserted their rights, the companies fought back. Even after the 1930s, when the New Deal labor laws gave legal backing to the United Mine Workers union, the companies maintained their stranglehold over coal country.

## REFORM

When West Virginia Governor William Marland proposed in 1953 to tax extractive industries for the benefit of schools and roads, he failed due to the influence of coal lobbies in the legislature. Governors had attempted to enact severance taxes in 1902 and 1914. Not until the 1970s did West Virginia pass the tax, a sales tax of 5 percent or less, depending on source of coal. The thin seam coal for which mountaintops were removed was taxed at only 1–2 percent. The money didn’t find its way to economic development.

Abandoned coal mines create many problems. Run off and sedimentation contaminate municipal water supplies far from the mine sties. Acidic drainage damages roads and other infrastructure. And mine sites were attractive play sites for children, killing 11 children in one Oklahoma county alone. The Surface Mining Control and Reclamation Act of 1977 (SMCRA), established the first federal regulation of mining. By then, U.S. coal operators had left 1.1 million acres of abandoned coal mine sites. SMCRA funds can clean up only 40 percent of the abandoned mines.

In 1991, U.S. Secretary of Labor Lynn Martin reported that over one-third of the mines in the

United States submitted tampered-with dust samples, commonly vacuumed monitoring cassettes. The department fined 500 operators of 785 mines more than \$6.5 million. The purpose of the testing was to reduce the incidence of black lung disease. Because the companies argued that the results could have been the result of careless handling, there was no prosecution. In 1998, the *Louisville Courier-Journal* documented that the 1997 records showed 80 percent of the country's underground mines were impossibly clean. One method was to turn off the dust pumps so nothing collected in the sampling cassette.

## ENVIRONMENTAL DISASTER

Mining meant stripping away mountaintops. The objections to blasting mountaintops into the valleys and streams were aesthetic, of course, but there were legal objections to the practice in Virginia, Kentucky, West Virginia, and Tennessee. Neighbors were plagued with continual blasting, debris and dust, and overloaded coal trucks rumbling down deteriorating roads and streets. Displacement under duress commonly destroyed entire communities and their long histories. Strip mining of mountaintops destroyed streams and wildlife habitat and the water supplies of residents and the quality of their life. In West Virginia, the mining industry buried 1,000 miles of streams and eliminated 300,000 acres of hardwood forests. Mines were as large as 10 square miles, dumping hundreds of millions of waste into the valleys.

SMCRA authorized the mining if the operators met standards intended to safeguard the public and the environment. Some mining analysts say enforcement has been lax to nonexistent as state and federal regulators ignore company violations. The federal coal statute requires companies to show they won't damage a stream or they're prohibited from mining within 100 feet of it. And the Clean Water Act bars dumping of waste into streams. A court ruling of October 1999 in federal court did affirm that burying streams in the manner practiced by the coal companies was a violation of both coal law and the Clean Water Act.

In 2002, the George W. Bush administration decided to change the law rather than enforce the old one. The changed law requires reclamation unless the operators can show industrial or commercial development will occur on the new plateau. The

states interpret the requirement loosely, and they allow cutting of corners that renders even "reclaimed" lands useless. Blasting damage was prohibited by law. Companies routinely damaged homes, water, and public safety while regulators turned away.

Since after World War II, coal trucks have been growing larger, able to carry more weight than the roads were built to withstand. Coal companies subcontracted coal hauling. Trucking companies, not coal companies, violated the laws, and damaged the roads. As local residents, the truckers faced sympathetic juries. Late in the 20th century, the average violation was more than 42,000 pounds over weight. And the fatality rate in Kentucky's coal country was twice the average because excess weight affected braking and other handling capabilities.

In 1972, Buffalo Creek, West Virginia, flooded as a coal impoundment dam gave way: 125 people died, 500 homes were destroyed, the case drew publicity and litigation as the companies claimed their negligence was an act of God. Such spills were periodic and the National Research Council, a part of the National Academies, which included the National Academy of Sciences, appeared to be weighted toward the companies.

In October 2000, in Kentucky, the A.T. Massey Coal company subsidiary's 72-acre coal waste dam leaked, releasing 250 million gallons of coal slurry through abandoned underground mines into tributaries of the Big Sandy River, which runs to the Ohio. The case raised questions about the adequacy of inspection and enforcement.

John Braithwaite, in 1985, reported that an examination of 39 coal disasters found that they historically have occurred more as a result of company negligence rather than natural forces or human error. The recommended solution was punishment and education about how to reduce injuries, civil and criminal penalties, sanctions, procedural safeguards, and oversight of the offending companies to match the severity of the violation. Liability by both corporation and individuals would make for greater caution.

## SEE ALSO

Buffalo Creek; Mining Safety Health Act; pollution; Clean Air Act; Clean Water Act.

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JOHN BARNHILL, PH.D.  
INDEPENDENT SCHOLAR

## Coffee, John C., Jr. (1944–)

JOHN COFFEE, a professor at Columbia University Law School specializing in corporations and white-collar crime, is one of the field's foremost experts. Coffee was recognized by the *National Law Journal* as one of the "100 Most Influential Lawyers in the United States." Before joining the faculty at Columbia, Coffee was on faculty at Georgetown University Law Center and before that with the law firm of Cravath Swaine & Moore. He received a Bachelor's degree from Amherst College and law degrees from Yale Law School and New York University.

Coffee's articles have focused on the role of criminal and civil law in the punishment of white-collar crime. He notes that the line between civil and criminal law has disappeared. The blurring of the line between criminal and civil law will result in injustice and ultimately weaken the social control resulting from criminal law. Coffee explains the real difference between civil and criminal systems is the criminal system's operation of moral education and socialization. People obey the criminal laws because they perceive it as legitimate. Criminal law communicates a set of values, while the civil law balances the public versus private rights. The only time this distinction can be made and communicated is at sentencing. Coffee characterizes the civil system as "pricing," while he characterizes the criminal system as "prohibiting."

Coffee acknowledges the point made by legal scholars warning of "over-criminalization." Propo-

nents of over-criminalization argue that over-reliance on criminal sanctions, particularly with respect to behavior that is not morally culpable, will weaken the criminal system. In particular, proponents of over-criminalization decry the use of criminal sanctions when there is no fraud or there is no victim. In these cases, proponents of over-criminalization argue that crimes that lack fraud or crimes without a victim should be subject to civil court.

## BORDERLINE CASES

Coffee asserts that some cases fall on the borderline between pricing and prohibiting. One such area is corporate criminal liability. In the United States, corporate criminal liability is a form of vicarious liability, which is where the principal can be held liable for the actions of the agent even if the principal takes action to prevent the illegality.

In corporate criminal liability cases, Coffee argues the criminal court is moving into pricing, rather than prohibiting. In these white-collar crime cases, often the judge is making decisions on a case-by-case basis using standards vaguely defined in statute. Coffee asserts that courts should distinguish between cases where senior management directed the criminal activity, and in which case the court should use criminal "prohibitive" penalties. In cases, where senior management was not directly involved, the court should use the civil "pricing" penalty.

## SEE ALSO

corporate criminal liability; differential association; self-control theory.

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## Cohen, Albert K. (1915–)

ALBERT COHEN is a criminologist who studied delinquent gangs and the subculture of working-class boys. In 1955, he published *Delinquent Boys: The Culture of the Gang*. In this influential book, he argued that the norms and values of a delinquent subculture encourage and condone delinquent behavior.

Criminal behavior, according to Cohen, was not acceptable to the dominant culture. The delinquent subcultures that arose in poor, urban environments were rooted in class differences, parental aspirations, and the quality of schools. Groups of boys, frustrated with their apparently low position in society, would begin to act in ways that were rewarded by their own peer group. Crime or gang participation was a rebellion against middle-class standards. Through a process known as reaction formation, those who became delinquent could achieve status by seeing who could reject middle-class values the most.

Cohen asserted that the position of one's family in the social structure was a determining factor in the problems a child would later face in life. Although not all working-class boys became criminals, deviant behavior was a response to social conditions. Cohen stated that delinquent boys acted randomly, according to impulse, and that their misbehavior was a way to achieve peer approval. Thus, the delinquent subculture stemmed from lower-class boys banding together to define their own status. Their behavior was "non-utilitarian, malicious and negativistic," Cohen explained.

Cohen was a student of renowned criminologists Edwin Sutherland and Robert K. Merton. Cohen's delinquent subculture theory combined Sutherland's differential association theory with Merton's strain theory and culture conflict theory. In the 1950s, the public was concerned about juvenile delinquency, and middle-class values were being widely dispersed. Cohen attempted to find the origins of delinquent behavior among lower-class boys and teenage gang members who defied the middle-class goals. Cohen explained how these criminal subcultures had come to "flourish most conspicuously in the 'delinquency neighborhoods' of our larger American cities."

Cohen's work has been both supported and refuted. In *Delinquent Boys*, he asserted that "the delinquent subculture was mostly to be found in

the working class." However, he did not offer an explanation for the prevalence of white-collar crime. He also neglected to elaborate on why some formerly delinquent boys later became law-abiding. Many scholars and researchers in the criminology field have explored and tested his notion of the relationship between status deprivation and delinquency.

### SEE ALSO

Sutherland, Edwin H.; differential association; self-control theory.

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## Coleman, James W. (1947–)

JAMES WILLIAM Coleman in 2003 was a professor of sociology at California Polytechnic State University, San Louis Obispo. Coleman received his Ph.D. in sociology from the University of California, Santa Barbara, in 1975 and is a widely respected scholar in several distinct areas of research. These include the sociology of white-collar crime, the sociology of social problems, and the sociology of drug use. Other research areas investigated by Coleman include social foundations of Western Buddhism as well as the world system's political economy. His research on white-collar crime has been published in prestigious academic journals such as the *American Journal of Sociology* and *Social Problems*.

He is probably most well known as the author of *The Criminal Elite: The Sociology of White-Collar Crime*, a book that is in its fourth edition. Additionally, Coleman's work has appeared in edited books on white-collar crime, including Kip Schlegel and David Weisburd's *White-Collar Crime Reconsidered* and Neal Shover and John Paul Wright's *Crimes of Privilege: Readings in White-Collar Crime*. Coleman has been invited to present his research at numer-

ous national meetings, including Indiana University's 1990 Sutherland Conference on White-Collar Crime, where he reviewed the field's theories of white-collar crime beginning with Sutherland until the 1990s. Coleman's own theory of white-collar crime was initially developed in a 1987 article, "Toward an Integrated Theory of White-Collar Crime." In this seminal article, he argues that both wealth and success are common human goals. In the world of business, these factors contribute to a belief system referred to by Coleman as the culture of competition. Coleman's theory specifies that the culture of competition interacts with the motivations of individual offenders and subsequently results in the acts of white-collar crime.

To better understand white-collar crime and therefore prevent it, Coleman suggests that researchers focus on larger, macro-level factors such as capitalism, as well as factors unique to specific organizational settings, including various subcultures that may develop among employees. Most importantly, Coleman is an advocate for including micro- (pertaining to individuals) and macro- (pertaining to organizations) level factors for a more complete understanding of white-collar crime.

#### SEE ALSO

capitalism; free enterprise system; Sutherland, Edwin H.

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## commodities fraud

COMMODITIES FRAUD refers to certain illegal activities involving futures contracts traded in the United States on organized exchanges such as the Chicago Board of Trade, the Chicago Mercantile Exchange, the New York Futures Exchange, the MidAmerica Commodity Exchange, and the Kansas City Board of Trade. Commodities fraud pertains

to exchange members who fail to register with the exchange, perform transactions with no economic purpose other than to generate profit for the member of the exchange, provide false or misleading information to customers or steal customer funds.

Futures contracts are legally enforceable contracts, or agreements, where one party agrees to pay a certain price for a specified quantity of corn, soybeans, wheat, oil, petroleum, natural gas, or other commodity to be delivered on a specified date. Today, futures contracts have expanded beyond traditional commodities into financial instruments, and into such things as the weather.

#### EARLY FUTURES TRADING

Futures trading is not a recent development, it can be traced to Europe in the 18th century. The immediate predecessor was the "to-arrive" contract. This was simply a contract for the purchase of goods upon their arrival. For example, ship cargoes were often sold before their arrival in port on a "to arrive" basis.

The to-arrive contract also filled an important need in the grain trade in the United States, which had expanded rapidly during the 19th century. Grain prices, during the early stages of American development, were subject to a seemingly endless cycle of boom and bust. At the end of the crop year, farmers would flood the market with grain, and prices would drop drastically. Grain would then be left to rot, or simply be dumped, as prices became so low that transporting it to market became a losing proposition. Later in the crop year, shortages would develop and prices would rise as dramatically as they had fallen.

Consequently, buyers and sellers sought to provide for their needs by contracting for the delivery of quantities and grades of grain at an agreed-upon price and delivery date in the future, depending on when the grain would be needed and when it was available. This was accomplished through to-arrive or forward contracts. Soon, a practice developed whereby these to-arrive contracts were themselves bought and sold in anticipation of changes in market prices.

Just as futures contracts are nothing new, neither is fraud new to commodity markets. In the 1880s, "bucket shops," an early form of commodity fraud appeared. A bucket shop is an establishment where bets can be made on current prices for com-

modities. The bets are not executed as contracts on any exchange, but rather are placed on the bucket shop's books, just as would be done by a bookie, who offsets his bets by his own resources. Such resources were often sadly lacking, as discovered by successful wagerers when they came to collect their winnings.

The Chicago Board of Trade sought to stop the bucket shops by cutting off access to its market quotations, upon which the bucket shop operations were wholly dependent for their operations. Nevertheless, the bucket shops continued to thrive due to competition from other exchanges which provided the bucket shops with market quotations. States attempted to pass legislation regulating bucket shops. By 1922, it was clear that neither the self-regulatory approach of the exchanges through their rules or state laws would eliminate or even curtail the fraudulent bucket shops. Therefore, in 1922, Congress enacted the Grain Futures Act, and in 1936 Congress passed further legislation to prevent manipulation and fraud in the futures market.

In 1974, Congress transferred authority for regulating the futures market from the Department of Agriculture to a newly created independent agency, The Commodity Futures Trading Commission (CFTC). The CFTC continued the regulation of futures exchanges through self-regulation with federal oversight. The CFTC created a division of enforcement to sanction exchange members who engaged in deceptive or fraudulent activities.

## THE CFTC AND FRAUD

The CFTC's first non-option related fraud case involved the American International Trading Company (AITC), a Los Angeles-based company headed by Harold Berman. The company offered a managed-account program for trading in commodity futures contracts and required an investment of as little as \$2,000.

AITC promised profits to speculators and guaranteed customers that they would not lose more than they invested, that is, customers would not be subject to margin calls. The program was widely advertised in Los Angeles. Berman even conducted television shows on a Los Angeles financial broadcast station, where one of his guest stars was Jack Savage, who acted as an adviser to AITC.

The CFTC charged that Savage and Berman operated a scheme to cheat and defraud AITC cus-

tomers. One way this was carried out was by wash sales. Berman entered opposite buy and sell orders for AITC customers that had no effect except to generate commissions for AITC. In addition, it was charged that Berman and Savage entered into pre-arranged trades for customers on the floor of the MidAmerica Exchange in a manner that allowed Savage to make large profits to the detriment of AITC customers. AITC was additionally charged with entering into a series of "Robin Hood" transactions where profitable sides of offsetting trades were allocated to customers whose equity had declined below zero, requiring AITC to meet their margin calls. The nonprofitable sides of those trades were placed in the accounts of AITC customers with positive equity balances. This trading effectively transferred funds from customers with positive equity balances to customers with negative balances.

## RELIEF AND SANCTIONS

The CFTC obtained injunctive relief and administrative sanction against AITC, Berman Savage, and others. AITC was closed down and a civil penalty of \$250,000 was imposed by consent, although it was never collected. Savage appealed the injunction obtained by the CFTC. Although he was successful in some issues, the injunction was affirmed in other respects.

Another early case of fraud involved the Citadel Trading Company of St. Louis and Steward Fason, the author of a book entitled *A License to Steal*. The book depicted the asserted trading successes of its author in the futures market, where he purportedly had made over \$1 million. Fason promoted his book by offering to trade the funds of persons attending seminars he gave and by extolling his trading methods. In making that offer, Fason advised prospective investors that he would retain 20 percent of their net profit as the sole compensation for his successful trading of their accounts. He would waive that fee for six months for persons who allowed him to trade their accounts and would then give him an affidavit certifying his trading success. Fason claimed that he wanted to use these affidavits to promote his book.

Fason placed the funds of a large number of customers who responded to the offer with the Citadel Trading Company. There, the funds were traded in wash sales and other transactions designed

simply to generate commissions that were secretly shared with Fason through deposits in an account he controlled.

That account was designated as the "ALTS" account. It was also discovered that Citadel was using customer funds to pay for an automobile, an apartment, and other personal expenses. Administrative sanctions were entered against Citadel and Fason. A floor broker handling the Citadel wash sales was also barred from registration as a floor broker for a period of five years.

### UNAUTHORIZED TRADING

Other significant fraud cases involved charges of unauthorized trading. For example, in a case brought against Jeffrey Silverman, the respondent had entered unauthorized commodity futures trades for eggs and pork bellies, and continued to do so even after at least one customer objected. The Seventh Circuit court upheld the CFTC's order, prohibiting Silverman from trading futures contracts on U.S. exchanges for a period of two years.

Similarly, in a case against Robert Haltmier, the account executive was sanctioned for entering several unauthorized transactions for a customer who was traveling abroad. The CFTC's action was upheld by the Second Circuit, but the court criticized the CFTC for prohibiting Haltmier from trading on U.S. exchanges. The Second Circuit pointed out that Haltmier's conduct involved the illegal trading of customer accounts, for which he should have been sanctioned, and not his own personal trading, to which the prohibition applied.

A more sophisticated illegal form of unauthorized transactions arose involving Winchester-Hardin-Oppenheimer Trading Company. There, it was charged that respondents had engaged in a fraudulent scheme to allocate profitable transactions to a nominee account of a respondent and losing trades to customer accounts.

The Division of Enforcement has also brought numerous registration denial and revocation cases. Applicants were denied registration for bank robbery, false statements in a CFTC registration application, petty larceny, felony tax violations, a conviction for false statements to the Department of Housing and Urban Development, acting without required registration, federal securities law violations, and failure to disclose to the CFTC prior part-time employment as a real estate salesman.

On the other hand, a convicted counterfeiter was allowed to register. In the much publicized registration case against Larry Williams, the Division sought to deny Williams registration as a commodity-trading adviser on the grounds that he had previously been sanctioned by the Securities and Exchange Commission (SEC) on the basis of a consent settlement and that he had misleadingly promoted his futures trading system and his book on futures trading, entitled *How I Made \$1,000,000 Trading Commodities Last Year*. Williams had promoted his futures system through seminars for which he charged \$1,500 per participant and offered gains of 100 percent. Over 500 people attended these seminars.

The case against Williams suffered several weaknesses. The SEC had reinstated Williams' registration as an investment adviser, undercutting the suggestion that his prior securities activities were evidence of his continuing unfitness to deal with the public. The division's claim that Williams had misrepresented his trading successes in his book were also nebulous. The division asserted that, while he had made \$1 million trading, not all of that profit was for his own account. But this was not found to be misleading, since customers were concerned about trading results, not who benefited. A CFTC administrative law judge did find that Williams had been at least negligent with respect to misleading statements in announcements promoting his seminars because he portrayed his trading system as perfect, when, in fact, it had serious flaws. The CFTC, however, concluded that because the conduct occurred before the creation of the CFTC, it would not be used to disqualify him from registration.

A continuing problem for the Division of Enforcement has been abuses by commodity pools and their advisers. The large amount of liquid funds that may be obtained from the public for the operation of these pools made them particularly susceptible to abuse. Perhaps the most famous commodity pool case brought by the division (whose efforts were spear-headed by John Cotton) involved Chilcott Portfolio Management Inc., an Oklahoma firm that was the creation of Thomas D. Chilcott, and which was placed in receivership by the CFTC. Chilcott converted (stole) over \$80 million of funds it had solicited from over 400 customers.

More recently, the CFTC has investigated and prosecuted foreign-currency fraud involving futures or options. Currency trading scams often attract



customers through advertisements in local newspapers, radio promotions, or attractive internet sites. These advertisements may boast purportedly high-returns, low-risk investment opportunities, or even highly paid currency-trading employment opportunities. During fiscal year 2002, the CFTC filed 12 enforcement actions against 61 defendant firms and individuals selling illegal foreign-currency futures and option contracts.

The fraudulent activities of these scam artists is increasingly becoming more sophisticated. In some cases, the defendants continuously move their operations to evade the CFTC's jurisdiction by claiming they were dealing with regulated counterparties (some in foreign locations) or that the contracts sold were spot (and not futures) transactions. Commodities fraud will continue to be a problem in the 21st century. As with other financial markets, the increased availability of more sophisticated technology has transformed the structure of the industry and increased the opportunity for fraud.

#### SEE ALSO

Commodity Futures Trading Commission; securities fraud; stock fraud; fiduciary fraud.

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## Commodity Futures Trading Commission

THE COMMODITY Futures Trading Commission is an independent agency of the federal government created by the Congress in 1974 to regulate commodity futures and option markets in the United States. The CFTC is responsible for ensuring mar-

ket integrity and protecting market participants against manipulation, abusive trading practices, and fraud.

A futures contract is an agreement to buy or sell in the future a specific quantity of a commodity at a specific price. Most futures contracts contemplate that actual delivery of the commodity can take place to fulfill the contract. However, some futures contracts require cash settlement in lieu of delivery, and most contracts are liquidated before the delivery date. An option on a commodity futures contract gives the buyer of the option the right to convert the option into a futures contract. Futures and options must be executed on the floor of a commodity exchange (with very limited exceptions) and through persons and firms who are registered with the CFTC.

Most of the participants in the futures and option market are commercial or institutional users of the commodities they trade. These users, most of whom are hedgers, want the value of their assets to increase and also want to limit, if possible, any loss in value. Hedgers may use the commodity markets to take a position, which will reduce the risk of financial loss in their assets due to a change in price. Other participants are speculators who hope to profit from changes in the price of the futures or option contract.

Futures contracts for agricultural commodities have been traded in the United States for more than 100 years and have been under federal regulation since the 1920s. In the last 20 years, futures trading has expanded rapidly into many new markets, beyond the domain of traditional physical agricultural commodities. Futures and options are now offered on many energy commodities such as crude oil, gasoline, and natural gas, as well as on financial instruments, including foreign currencies, U.S. and foreign government securities, and U.S. and foreign stock indices. In addition, in recent years, new futures contracts have been offered in nontraditional commodity areas such as electricity, seafood, dairy products, crop yields, and weather derivatives.

The CFTC has responsibility to the markets and their users for contract review and market surveillance. To ensure the financial and market integrity of the nation's futures markets, the CFTC reviews the terms and conditions of proposed futures and option contracts. Before an exchange lists a new futures or option contract for trading, it must certify that the contract complies with the requirements of

the Commodity Exchange Act (CEA) and the commission's regulations, including the requirement that the contract terms reflect commercial trading practices and that the contract cannot be readily susceptible to manipulation. The commission conducts daily market surveillance and can, in an emergency, order an exchange to take specific action or to restore orderliness in any futures contract that is being traded.

The CFTC also has responsibility to the markets for regulating futures professionals. Companies and individuals who handle customer funds or give trading advice must apply for registration through the National Futures Association (NFA), a self-regulatory organization approved by the CFTC. The CFTC also seeks to protect customers by requiring registrants to disclose market risks and past performance information to prospective customers, by requiring that customers' funds be kept in accounts separate from those maintained by the firm for its own use, and by requiring customer accounts to be adjusted to reflect the current market value at the close of trading each day. In addition, the CFTC monitors registrant supervision systems, and internal controls and sales-practice compliance programs.

### COMPLEMENTARY RULES

Commodity exchanges complement federal regulation with rules of their own, rules covering clearance of trades, trade orders and records, position limits, price limits, disciplinary actions, floor-trading practices, and standards of business conduct. A new or amended exchange rule may be implemented upon certification by the exchange that the new or amended rule complies with CEA and commission regulations. The CFTC may also direct an exchange to change its rules or practices if found to be in violation. The NFA performs similar functions for non-exchange member firms. The CFTC also regularly audits each exchange and the NFA's compliance program.

### SEE ALSO

commodity fraud; securities fraud; stock fraud.

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## compliance programs

COMPLIANCE PROGRAMS generally refer to internal policies and procedures that private sector companies must implement to ensure adherence to specific government-imposed laws and regulations. Requiring compliance programs in the private sector is part of a broader government regulatory enforcement strategy. The application of the so-called compliance strategy by governments has increased in recent years to help stem both regulatory and criminal infractions committed by or against private-sector companies. Compliance programs are meant to reinforce a broad fiduciary duty on companies, requiring them to act in the best interest of their clients, stockholders, or society in general. They are also meant to protect the company, by forcing them to enact policies and procedures to protect against fraud, money-laundering, or other crimes.

Compliance strategies derive from the nature of regulatory law which produces a situation in which an organization's main role is seen to be the maintenance of high standards and compliance with regulations. When compared with criminal sanctions, compliance strategies are often pursued by governments as a less punitive method of regulating industries.

Moreover, compliance programs differ from more punitive, (reactive) enforcement approaches in that they are largely proactive: compliance strategies are meant to encourage companies to have policies and programs in place to ensure that unethical behavior, regulatory infractions or criminal behavior does not occur in the first place.

Some experts have criticized this compliance approach, arguing that it can be easily circumvented and treats the perpetrators of white-collar crime (individuals in the upper classes) much too leniently, especially when compared with property crime of-

fenders, which is more often committed by those with lower socioeconomic status.

The Securities and Exchange Commission (SEC) and the Federal Reserve Board (FRB), two of the American government regulators of the private sector, have both increasingly relied on compliance strategies in relation to its regulated entities. In 2003, the SEC proposed new rules that would require investment companies and advisers regulated by the SEC “to adopt and implement policies and procedures reasonably designed to prevent violation of the federal securities laws, review those policies and procedures annually for their adequacy and the effectiveness of their implementation, and appoint a chief compliance officer to be responsible for administering the policies and procedures.” The proposed rules, entitled Compliance Programs of Investment Companies and Investment Advisers, are ultimately designed to protect investors “by being the first step toward enhanced compliance achieved through private initiative.”

The SEC conducts examinations to determine whether its regulated entities are adhering to federal securities laws. They are also meant to “identify compliance problems at an early stage, identify practices that may be harmful to investors, and provide a deterrent to unlawful conduct.” However, like most government regulatory agencies, it is limited in its capacity to examine the thousands of companies that fall under its authority. As such, regulators like the SEC are beginning to require companies to put in place their own internal compliance policies and procedures, including a designated compliance officer as well as measures to audit and test the compliance program. The SEC believes that regulated entities with effective internal compliance programs administered by competent compliance personnel are much less likely to violate the federal securities laws. Moreover:

If violations do occur, they are much less likely to result in harm to investors. In contrast, we have learned to regard weak controls as an indicator that undetected (and uncorrected) violations may have occurred, and we have assumed that, until improved controls are implemented, investors are at risk. Accordingly, our staff focuses its examination efforts on testing the effectiveness of controls and related compliance procedures, and requests that management correct any weaknesses that the staff discovers.

This focus allows us to leverage our limited examination resources; we are able to direct additional resources to firms with weaker compliance controls, and may examine them more closely and more frequently.

As implied above, some government regulators now believe that their examination efforts are better focused on ensuring that companies have compliance programs in place, as opposed to conducting examinations that are meant to directly identify infractions against relevant laws and regulations. One of the principal activities of the FRB, for example, is to ensure its regulated financial institutions have in place policies and procedures that comply with federal anti-money laundering laws. Compliance audits are conducted by hundreds of FRB examiners, who are responsible for reviewing anti-money laundering programs of more than 1,300 financial institutions in the United States. In addition, FRB regulations require that financial institutions provide for independent testing of compliance with federal money laundering laws by bank personnel or an outside party.

In 2004, the most stringent and widespread government-mandated compliance programs center on measures to combat money-laundering and terrorist-financing. In the United States and numerous other countries, financial institutions and numerous other categories of companies other must implement anti-money-laundering (AML) programs in order to be in compliance with federal and state laws.

The legal requirements for anti-money-laundering compliance programs were intensified in the United States through Title III of the USA Patriot Act (International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001), which requires all financial institutions to implement strict procedures and controls for screening client lists and transactions against government lists of suspected terrorists, drug dealers, money launderers, and other criminals. The act also requires certain additional due diligence and record-keeping practices. In order to ensure these measures are in place, Section 352 of the act requires all financial institutions to implement an anti-money-laundering program. Failure to comply can result in penalties of up to \$1 million.

The penalties attached to noncompliance are meant to combine a carrot-and-stick approach to

regulation of private sector companies: compliance programs allow companies to be largely self-regulating, however, failure to act may result in substantial criminal and civil penalties. The strength of a government compliance strategy “lies in its recognition that persuasive strategies and self-regulation can be effective only if backed up by the threat of tough and credible sanctions,” author Hazel Croall explains.

#### SEE ALSO

corporate criminal liability; reform and regulation; money-laundering; Securities and Exchange Commission; Bank Secrecy Act.

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## Comprehensive Thrift Act

ON NOVEMBER 29, 1990, President George H. W. Bush signed the Crime Control Act of 1990 into law. It was a series of acts designed to reduce crime in a variety of ways. One particular provision, Title XXV of the Crime Control Act, which is better known as the Comprehensive Thrift Act and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, deals with the prevention of financial misconduct by banking institutions.

Proposed by Senator Joe Biden (D-D) and co-sponsored by Senator Strom Thurmond (R-SC), Title XXV of the Crime Control Act greatly improved banking law enforcement to prevent and punish previous financial misconduct through a number of provisions, outlined into nine different subsections. Title XXV increases criminal penalties and allows for imprisonment if a banking official conceals assets from the Federal Deposit Insurance

Corporation (FDIC), obstructs government examination of a financial institution, or commits bank fraud. Prison sentences for banking officials guilty of bank fraud or embezzlement may be as high as a maximum of 30 years.

Also, former felons of certain crimes like perjury or breach of trust are prohibited from working or participating at a financial institution for at least 10 years. Under the legislation, undercapitalized banks, or those banks whose operations are hampered by a lack of capital, are prohibited from making indemnification payments to parties related to the affected cash-strapped institutions. After penalties for misconduct have been assessed, the act directs the U.S. Sentencing Commission to restore properties or money lost through financial violations to related bank crime victims.

Title XXV amends other laws related to financial crimes in order to protect assets from wrongful disposition. The Federal Deposit Insurance Act and the Federal Credit Union Act were amended to provide clearer guidelines for asset attachment procedures. The amendment improves the procedures for dealing with financial misconduct cases and modifies the federal response structure for crimes by financial institutions. Reporting requirements for the attorney general were changed and they specify that the attorney general must compile reports on major criminal investigations related to finance, and present reports that detail the status of each federal judicial district and the actions of the Financial Institutions Unit.

The act establishes the National Commission on Financial Institution Reform, Recovery, and Enforcement to research and reach conclusions concerning the causes of problems within the savings and loan scandals of the 1980s which led to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). FIRREA was amended to increase appropriations over the next two financial years (1991–93) to the attorney general, Internal Revenue Service, and the federal court system in order to better prosecute and ameliorate bank crimes.

At first, banking officials were unsure of the eventual implications of the sweeping provisions of the Comprehensive Thrift Act and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990. However, they were able to circumvent certain new regulations by acting as an individual independent of a financial institution. Still, the act provided the

Attorney General and the Federal Deposit Insurance Corporation (FDIC) with more power to take action against banks operating in a fiscally unsound manner and to recover assets which were improperly lost by financial institutions or citizens.

#### SEE ALSO

bank fraud; savings and loan fraud; Bank Secrecy Act; Sentencing Guidelines, U.S.

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## Computer Fraud and Abuse Act

COMPUTER-RELATED crime grew exponentially throughout the 1990s. Into the 21st century, computer-related crimes have become more and more prevalent and diverse. The primary federal statute used in combating the various types of computer crime is 18 U.S.C. § 1030(a)(1)-(a)(7). Section 1030, is better known as the Computer Fraud and Abuse Act (CFAA).

It was enacted originally in 1986 and has been several times by Congress. The CFAA includes an extremely expansive definition that includes coverage of all “protected” computers from a wide variety of activities of unauthorized access to and/or theft of information from “protected” computers.

A “protected” computer includes any computer “used in interstate or foreign commerce or communication.” In other words, the CFAA allows punishment of all unauthorized access to and/or theft of information, in a variety of manners, government, as well as from private, computers. The original statute only included a “federal interest computer” but this was too limiting given the substantial growth of the internet.

The CFAA is comprised of seven main subsections, (a)(1) through (a)(7), aimed at defining specific computer-related criminal conduct. The first subsection prohibits accessing a computer without authorization or in excess of authorization and using information, which could be used to injure the

United States. The second subsection prohibits obtaining, without authorization or in excess of authorization, information from a financial institution.

The third subsection prohibits intentional, without authorization or in excess of authorization, access of a nonpublic computer of a U.S. department or agency. The fourth subsection prohibits access to a protected computer with the intent to defraud or obtain anything of value. This subsection also requires without authorization or in excess of authority.

The fifth subsection is the primary anti-hacking section of the CFAA. This subsection makes it a crime to intentionally damage a protected computer without authorization through the transmission of a program, information, code or command. This subsection is an amendment to the original statute. Under this subsection, if harm does result from unauthorized access, even if there was no intention of harm, the perpetrator could still be punished by law.

The sixth subsection criminalizes the unauthorized access and trafficking of passwords or similar information where it is done knowingly and with the intent to defraud. The last subsection prohibits the transmission of communication which contains any threat to cause damage to a protected computer and extort or gain anything of value from that transmission.

Given that the CFAA is a federal statute, the Federal Sentencing Guidelines govern sentences. In 1996, Robert Morris, a Cornell University graduate student, was the first person prosecuted under the CFAA. Morris created a worm, a computer virus that infected over 6,000 computers across the United States. He was sentenced to three years probation, fined over \$10,000 and ordered to perform 400 hours of community service. The public was not pleased by the light sentence. In 1997, Congress directed the U.S. Sentencing Commission to provide for a minimum of six months of imprisonment for defendants convicted under sections 1030(a)(4) and (a)(5).

The CFAA provides a tool for the criminal justice system to respond to illegal use of computers, but a central problem remains. The identification of perpetrators and the ability to effectively use the CFAA relies on law enforcement personnel who may not be as familiar with a computer and various software systems and digital files as the potential perpetrator.

## SEE ALSO

computer hacking; cyberstalking; wire fraud.

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## computer hacking

BEGINNING IN THE 1980s, as new technology made what former Vice President Al Gore called the Information Superhighway possible, the world has become smaller and more vulnerable. Any computer that is connected to the internet or to a network opens a line of communication that can be accessed by computer hackers around the world. Computer hackers have been responsible for threats to national security, credit-card and identity theft, software piracy, financial fraud, trade-secrets theft, information theft, denial of service attacks, wanton destruction of data, software, and hardware, and various other malicious behaviors.

It is difficult to estimate the full extent of the damage caused by computer hackers because of under-reporting. Estimates of annual costs have ranged from \$555 million and \$13 billion. When government agencies or businesses are attacked, costs include downtime, lost business opportunities, salaries for staff who spend time repairing damage, and fees for consultants and lawyers. Homeowners who have been maliciously hacked may have to replace a damaged hard drive or even an entire computer.

Originally, the term *hacker* was used to identify anyone who gained entry into another computer without the consent of the owner. The typical hacker was curious about the way that computers worked and how they communicated with each other. This sort of hacker has also been called “benign” or a “white hat.” Some companies have hired these hackers to test their systems and to find and plug holes in operating systems such as Unix or Windows or to protect confidential information

and products. When most people refer to computer hackers, they are referring to what is also known as “crackers” or “black hats.”

Unlike the traditional hacker, the cracker is interested in accessing other computers for malicious or criminal purposes. This individual is generally profiled as a young, male computer genius. He is often characterized as precocious, curious, and persistent. He may be delinquent, hyperactive, or a drug or alcohol abuser. The cracker is also known to lie, cheat, steal, and exaggerate. A network of hackers has developed through online bulletin boards, 2600 magazine, and through other less formal means of communication. Networking allows hackers to communicate with one another, to trade hacking techniques, to identify holes in operating systems and other software, and to brag about their exploits to one another. The more professional hackers who belong to this network are critical of uninitiated hackers who are called “script kiddies” who may download hacking software from the internet rather than calling on their own skills and initiative to engage in computer hacking.

Hackers enter computers for a number of reasons and may come from either inside or outside a company, agency, or network. Inside hacking is generally performed by employees or former employees who illegally or unethically try to access privileged information or attempt to manipulate or destroy information. They may also hack simply out of spite or revenge. Outside hackers may be interested in stealing proprietary information such as user passwords that allow access to entire networks, or in stealing trade secrets or source codes or financial records. Others may be looking for personal information to pave the way for identity theft. Still others may be interested in setting up denial of services attacks that have been known to crash the entire systems of government entities and large corporations, or the hackers might just enjoy snooping or acting maliciously.

## MALICIOUS HACKING

Viruses, worms, and logic bombs have become common tools by which computer hackers create extensive havoc. Viruses are intended to “infect” a computer and can do anything from launch a denial of service attack to e-mailing thousands of recipients. The worm copies itself and exploits weaknesses in the computer system. Although they are

not usually criminal in intent, viruses and worms can be costly. The Melissa worm, created by New Jersey programmer David L. Smith, for example, cost an estimated \$80 million in damages as it spread its havoc through cyberspace. In 2003, the so-called Blaster worms hit hundreds of thousands of computers and spawned a number of variants. Logic bombs create damage by “exploding” at a designated time or when a particular action is performed. From 70,000 to 90,000 viruses and worms were identified in 2003 alone.

Malware, also known as a “Trojan Horse,” is malicious software that is intended to plant a program on a computer, without the owner’s knowledge, that will cause certain outcomes. For example, malware can attach itself to software such as Microsoft Word or Power Point and set a sequence in play that allows the hacker to do things like cause a CD drive to open on its own or to play a music file in the middle of the night. Malware may have a more sinister purpose. For instance, it may install a program that allows the hacker to listen in on conversations around the computer, even if the com-

puter’s microphone is turned off, or it may record a user’s keystrokes to transmit information back to the hacker.

## CRIMINAL HACKING

The first federal prosecution for computer hacking occurred even before access to the internet became commonplace. In 1966, a computer programmer under contract to a Minneapolis, Minnesota, bank experienced what he saw as a temporary shortage of funds. He manipulated his own account so that no overdrafts were reported. He found the fraud so easy that eventually \$14,000 in overdrafts were hidden within a computer program that only he understood. Unfortunately, when the system crashed and accounts were recorded manually, the hacker was caught. A number of criminals now use computers to perform crimes that would have required physically breaking and entering businesses a few decades ago. For example, in 1997, an FBI sting at the San Francisco International Airport netted a criminal who was trying to sell a compact disk with 100,000



*For computer hackers, the click of a mouse that launches a worm or virus can lead to a criminal conviction.*



*Identity theft, credit-card fraud, and plain malfeasance are some of the goals of computer hackers.*

credit card numbers on it for \$260,000. The list had been retrieved by hacking into various computers and was encrypted using the first paragraph on page 128 of Mario Puzo's *The Last Don*.

Kevin Mitnick may be the most notorious computer hacker in the United States. In July 1999, Mitnick pled guilty to one charge of cellular telephone fraud and was sentenced to eight months in jail and banned from using a computer. Mitnick had originally been charged on 23 separate counts of telephone and computer fraud. While serving time in jail, Mitnick became a cult hero. Since he had never faced trial, many Americans believed that Mitnick had been railroaded by overzealous government prosecutors. Mitnick was 17 the first time he was arrested for computer hacking in 1980. He became so adept that he evaded capture by the FBI and other government agencies for two years.

Mitnick was finally captured on February 14, 1995, after he targeted "white hat" Tsutomu Shimomura. Mitnick activities cost businesses close to \$300,000. After being released from prison and regaining the right to use a computer, Mitnick turned his extensive talents to working with business and industry to improve computer security and to prevent other hackers from doing what he had done for years.

In 1988, Clifford Stoll, an astronomer at Lawrence Berkeley Laboratories in California, did what no government agency in the United States had been able to do. Through virtually devoting his life over a period of months to catching a hacker that he dubbed the "Hanover Hacker," Stoll, with a lot of help from his friends, uncovered a spy ring of German youths who were selling government secrets to the KGB in the Soviet Union.

Adrian Lamo called himself a white hat, insisting that he only broke into computer systems to identify weak spots that might be used by black hats to do malicious or criminal damage to the system. *The New York Times*, however, believed that Lamo is a simple crook. According to the Federal Bureau of Investigation (FBI), which arrested Lamo on August 1, 2003, the 22-year-old hacked into the *Times* computer on a regular basis between February and April of the previous year.

He accessed confidential information, costing the newspaper more than \$25,000 to repair damages and an additional \$300,000 that had been billed to the *Times* for time Lamo spent on the service Lexis-Nexis.

Four American teenagers hacked into the Bay Area Internet Service computers and stole credit cards, ordering \$200,000 worth of computers from an online auction. They were apprehended when they picked the computers up at an empty house after school.

## COMPUTER LAWS

The Computer Fraud and Abuse Act of 1986 made it a federal crime to intentionally access a computer without authority or by exceeding authority to obtain information to which one is not entitled. This act covered illegal access to computers owned or operated by the government, those connected to the government, and those involved in interstate and foreign commerce. The act has been amended a number of times to make it more responsive to changes in technology. States have also developed their own laws to make hacking a criminal offense.

The Economic Espionage Act (EEA) of 1996 was a response to the growing network of professional spies and saboteurs who earn enormous payments for hacking the computers of rival governments or businesses. These professionals are highly elusive and are capable of destroying computers and/or networks, crashing stock markets, or even bringing down governments. EEA made it a federal offense to profit in any way from the misappropriation of another person's trade secrets, including downloads, uploads, and e-mails.

## COMPUTER PROTECTION

A number of basic tools have been used to provide protection from computer hackers. The most commonly used method is to require passwords to gain access to particular systems, services, or programs. Computer security experts suggest that passwords should not be words found in dictionaries or words that are associated with a particular individual. A more sophisticated method of protection is to encrypt information so that hackers cannot easily read it. Firewalls are often used to block unauthorized access to an individual computer or network.

Anti-virus programs are used to identify, remove, or quarantine viruses and worms. These programs are only useful if they are updated on a regular bases because new viruses and worms are being created daily. The bottom line is that the only computer that is entirely safe from a knowledgeable,



determined computer hacker is a stand-alone computer with no form of outside access.

#### SEE ALSO

identity fraud; credit-card fraud; internet fraud; Computer Fraud and Abuse Act; economic espionage.

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## conflict theory

CONFLICT THEORY and Marxism attempt to explain the exploitative dynamics of the Industrial Revolution that led to the mass production goods and the loss of the workers' control over their own creativity. Conflict theory primarily argues that it is the economic system of capitalism itself that produces crime.

Specifically, the Industrial Revolution primarily benefited the bourgeoisie, the owners of the means of production, while exploiting the land and the common worker, or the proletariat. Workers and the environment became tools or resources used to expand the wealth of the elite classes. Conflict theory hypothesizes that society is structured based upon the relationship of people to the production of material goods. In other words, those who own the means of production also control the workers, politicians, and development of criminal and civil law. Thus, the wealthy exploit the animals, the natural resources, other people, and the environment in

order to increase their power and wealth. According to conflict theory, the exploitation of the work force is a crime of economic domination in that it creates high levels of economic inequality, or gross disparities in income between the owners of the means of production and the proletariat or workers.

This inequality is result of the bourgeoisie's attempts to maximize their profits while minimizing their costs, specifically the wages of workers as well as the costs of maintaining the workplace. However, the workers sometimes strive to gain more control over their labor by improving their working conditions, their wages, and sharing in the profits from their labor. Thus, this relationship between the bourgeoisie (the owners) and the proletariat (the workers) is characterized by conflict. This antagonistic relationship, characterized by exploitation, alienation, domination, and inequality also explains crimes of resistance committed by the working class. These include workers' strikes, protests, walk-outs, and labor stoppages.

Conflict theory also explains crimes of repression committed by the wealthy, in conjunction with the state, in the development of criminal and civil laws that favor the elite classes and disfavor the working class and the poor. Crimes of repression include the violations of civil rights of workers, repression of union activity, the differential treatment of non-citizen workers from citizen workers, corporate welfare, and subsidies from the government, while welfare for poor families is characterized by politicians and the elite as the roots of all evil. Only two percent of the federal budget includes cash benefits for the poor while the subsidies for industry have cost taxpayers millions of dollars more.

Some criminologists might also argue today that crimes of repression violate the human rights of the working class all over the globe, including unfair wages, unsafe workplaces, air and water pollution, and a legal system that remains accessible only to those with sizable bank accounts. Finally, conflict theory also explains crimes committed by the working class against other members of the working class. This includes what are referred to as typical street crimes. However, because the wealthy control the culture or the media, they create an ideology that misrepresents the truth about corporate crime, that is, that street crime is more harmful and more deadly than corporate crime when the opposite is true. Moreover, the elite convince the workers that

the greatest threat to their jobs and income are from immigrants or other minority members who will “steal” their jobs. In fact, it is the bourgeoisie who exploit the labor of immigrants and minorities by paying them less than white workers in order to, once again, improve their profit margins.

In accomplishing this exchange of laborers and control over the consciousness of workers, the wealthy create a conflict among the workers prohibiting them from realizing that their real enemy or oppressor remains the elite. The only way to change these dynamics is to transform the capitalist economy to one in which workers would share in the profits. Some companies do maintain employee profit-sharing today.

#### SEE ALSO

capitalism; free trade; globalization; labor crimes; elite crime; unions.

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## Conoco

CONOCO, or ConocoPhillips since the merger with Phillips Petroleum in 2002, is a major U.S.-based oil and petrochemical company with operations in 29 countries. As of 2002, the bulk of ConocoPhillips’ production operations were in the United States, Norway, and the United Kingdom with smaller operations in Canada, China, Dubai, Ecuador, Indonesia, Nigeria, Russia, Venezuela, and Vietnam.

The company also operates 18 refineries in the United States, the United Kingdom, the Czech Republic, Ireland, Germany, and Malaysia. The company’s 12 U.S. refineries make ConocoPhillips the largest oil refiner in America. The Conoco side of ConocoPhillips can trace its origins back to the Continental Oil and Transportation Company formed in 1875 to distribute petroleum products

across the American West. In 1884-85, Standard Oil acquired Continental Oil to distribute Standard Oil products.

In 1913, the company became independent after the break-up of the Standard Oil Trust. Short of oil supplies, Continental Oil merged with Marland Oil in 1928, forming the Continental Oil Company or Conoco. After a fierce takeover battle between Seagram, Mobil, Texaco, Marathon Oil and Unocal, DuPont bought Conoco in 1981 to secure access to cheap feedstock for DuPont’s chemical plants. DuPont divested Conoco in 1999 as part of a move away from the highly cyclical petrochemical business toward the life sciences. In 2002, Conoco and Phillips Petroleum merged in order to compete with super-majors like BP Amoco, ExxonMobil and Royal Dutch Shell.

Conoco has a mixed environmental record. In 1990, the company undertook to replace its fleet of single-hulled oil tankers with doubled-hulled tankers in response to the Exxon *Valdez* accident. That same year, Conoco paid \$23 million to settle a lawsuit brought by residents of Ponca City, Oklahoma who claimed that the Ponca City Refinery had polluted their groundwater.

During the past 10 years, Conoco has regularly fallen afoul of U.S. environmental protection regulations. The company accumulated the largest number of fines from the Oklahoma Department of Environmental Quality during the period of 1993–2001, paying \$250,000 for a series of self-reported violations between 1998 and 2001. For eight years until 1989, Conoco and Pioneer Nuclear Corporation ran a *de facto* low-level radioactive waste dump without a permit at the Conquista Uranium Mine in Texas.

Conoco has also been involved in a series of oil royalty disputes with federal and state authorities. In 1999, Conoco paid the state of California \$1.15 million to settle an oil royalty dispute. The company paid the federal government \$26 million to settle another oil royalty dispute in 2000. Conoco and several other vertically integrated oil companies evaded royalty payments, calculated as a percentage of the post price, by undervaluing the oil produced on state and federal land, making correspondingly lower royalty payments to the government.

#### SEE ALSO

Exxon *Valdez*; Standard Oil; air pollution; water pollution; corporate criminal liability.

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## consent agreements, decrees, and orders

IN THE U.S. justice system, a consent agreement refers to a voluntary approval or mutual understanding between two or more people. Such an agreement may then provide authorization for some act or purpose. An order can be defined as a written command or direction that is delivered by a judge or a court. Similarly, a related term, decree, serves to convey a declaration of a court by announcing legal consequences of the facts in a particular case. In the field of white-collar crime, all three of these terms are typically heard most often with regard to corporate crime.

Beginning with the early work of Edwin Sutherland, who conducted research on both white-collar crime and corporate crime, criminologists have been interested in the punishment of these offenders. Compared to common or street criminals, the perception that white-collar workers and corporations are sanctioned more leniently has persisted. However, the public has increasingly supported the idea of stricter punishment for white-collar offenders and particularly, corporations. Many of the most serious forms of white-collar crime have been perpetrated by corporations. Some corporate crimes, such as those resulting in environmental pollution, other damages, or even death, are viewed by the public as more serious than others.

A variety of sanctions may be used against individual white-collar offenders or entire corporations. For corporations, one of the most common of these is a monetary fine. In addition to this regularly used sanction, prosecutors have also attached penalties and terms that are very specific to the offense. Fines and other types of penalties, such as commu-

nity service requirements, are regularly contained within consent agreements and court orders.

Although the terms of consent agreements and orders may vary, one recent example of corporate crime outlines some general terms. In this case, decided in the summer of 2001, Liberty Publishing, a telemarketing company operating in the state of Pennsylvania, was sued for engaging in deceptive business practices and intimidation tactics during the course of a fundraising campaign. Although the campaign raised over \$3 million for police organizations, numerous acts of deception were uncovered. The consent agreement included the following specific terms: the company was banned from telemarketing in the state of Pennsylvania, its owner was ordered to pay \$75,000 in restitution to consumers, as well as investigation costs and civil penalties.

### SEE ALSO

Justice, Department of; prosecution.

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## consequences of white-collar crime

WHITE-COLLAR CRIME IS massive in its impact. It takes a toll on individuals specifically and society in general. Its toll can be characterized as economic harm, physical harm, and emotional harm. In terms of economic losses, criminologists agree that billions of dollars are lost annually to white-collar crime. In the savings and loan crisis alone, experts suggest that up to \$500 billion was lost to fraud. Estimates from the federal government suggest that white-collar crime costs up to 15 times as much as street crime. Not included in these estimates are the enormous ancillary economic costs that come along with the prevention, investigation, and prosecution of these offenses.

Economic costs are also experienced by individual victims. Whereas the average robbery nets

around \$900, the average bank fraud amounts to about \$100,000. White-collar crime victims often lose their entire life savings. Also, whereas one robbery usually only victimizes one person, a white-collar scheme generally victimizes hundreds or even thousands of individuals.

Physical costs also arise. It is not uncommon to hear of financial fraud victims experiencing health problems, but it is not just these white-collar crimes that lead to physical consequences. Unsafe products, unsafe working environments, and other corporate misdeeds cause far more deaths than are caused by criminal homicides each year. Attention to unsafe working environments surfaced when concern spread about exposure to asbestos in the 1980s. Today, individuals are still suffering the consequences of unsafe exposures to asbestos and other poisons and pollutants from decades ago.

There are also serious health consequences that are experienced by environmental crime victims. Love Canal is just one example: Between 1942 and 1953, the Hooker Chemical plant dumped its chemical wastes in an abandoned canal near Buffalo, New York. The canal was covered, and Hooker sold the property to a local board of education. An elementary school was eventually built on the site. In the mid-1970s, residents became aware of the problem. Investigators soon learned that residents near the canal had experienced a number of physical problems. One year, just one of 16 children born near the canal was born without any serious ailments.

Emotional costs also come along with white-collar crime. The most cited emotional cost has to do with the loss of trust that society experiences. Just as traditional crime victims and their contacts experience a higher fear of crime after victimization, those directly and indirectly victimized by white-collar crime experience a similar sort of fear—fear about their finances, their well-being, and so on. In a similar vein, legal scholar John Coffee has described demoralization costs that come along with white-collar crime. When individuals hear of supposedly “well-respected” individuals getting away with things at work, they become more likely to transgress as well. White-collar crime’s reach generally touches everyone. Brian Payne cites a study (2002) suggesting that one in three individuals is a victim of fraud every year. Taking this a step further, one could suggest that every individual in the United States is a potentially a victim of white-collar crime every three years.

#### SEE ALSO

Love Canal; fear of crime; consumer deaths; Environmental Protection Agency; Securities and Exchange Commission; Enron Corporation.

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## conspiracy

**LAWS AGAINST CRIMINAL** conspiracies were primarily enacted to combat organized crime. The crime of conspiracy is constituted by the agreement to act in concert with one or more persons to commit a crime. Agreement is the crime, and anyone consenting to participate can be criminally charged even if she did not carry out her part for the commission of the crime. Courts recognize people in a conspiratorial relationship have a much greater chance of successfully engaging in and covering-up more profitable and destructive offenses than a lone offender.

Many corporate crimes require a conspiratorial arrangement. Not only does the criminal conspiracy increase the odds of attaining an illegal goal, but it also brings the greater resources of a corporation to assist. Consequently white-collar crimes occurring in corporate or governmental organizations contain elements of criminal conspiracy. Classic examples are the Watergate scandal, the Heavy Electrical Equipment Price-Fixing Conspiracy, and savings and loans land-flip deals in the 1980s.

The need for collusion to commit many white-collar offenses is easily demonstrated. For example, to carry out land-flip deals between savings and loans in the 1980s, each institution traded the same piece of low-value real estate back and forth. With each transaction the “value” of the land increased creating evidence on paper of a higher selling price, and, therefore of higher value. After a few transactions the “paper value” of the land went from next-to-worthless to extremely high. Each savings and

loan official knew the property he authorized to purchase or sell was worthless. Once a high value was established by the inflated sale price, the property was used as collateral for a large loan executives had little concern about repaying. The scheme required officials in each institution to enter a prior agreement to engage in fraudulent sales.

An interesting aspect of criminal conspiracies is how well evidence of their existence is hidden. In that regard, the Heavy Electrical Equipment Price Fixing Conspiracy was a classic. Representatives from all companies that manufactured electrical equipment agreed before-hand which company would get a contract and what the price of various pieces of equipment would be. Following accepted practices, buyers submitted bids for expensive items such as generators and transformers to each company and the lowest bidder got the contract. Every company that bid was party to the conspiracy. The electrical-equipment companies designated which manufacturer among them would get a given contract by rigging bids in such a way as to leave little evidence of collusion. The arrangement allowed the conspirators to maintain an inflated price for all equipment for the benefit of every company.

## PHASES OF THE MOON

The brilliance of the scheme was how bids were rigged. Before any bids were received, the conspirators agreed on equipment prices. Depending on what phase the moon was in on the day bids were asked for, the equipment companies determined which company would submit the lowest bid. The lowest bid was the agreed-upon price set for a particular piece of equipment. All other companies submitted higher bids. For example, on full-moon phases, one company got the job and on half-moons another, and so on. Over time, each received its share of contracts at the highest agreed-upon price no matter what was ordered. Conspirators did not have to talk with one another since each knew exactly how to bid in advance to further the common interest of maintaining an artificially high price.

Entering a conspiracy subjects one to criminal charges that cannot be mitigated by arguing one did not carry out her part of the plot, or had no knowledge of the whole scheme. Watergate is a classic example as each conspirator committed different acts to attain the common illegal goal. Some committed burglary, others obstructed justice, made illegal pay

offs, violated other people's civil rights, and quite a few committed perjury. All, however, were indicted together. In a criminal conspiracy, every party to it is equally culpable, knowing its objective is illegal.

Applying laws against criminal conspiracy can be problematic. Perhaps the greatest criticism is that relatively minor crimes make offenders open to indictment under conspiracy laws if cooperation is evident. The penalties for collusion can be much greater than those for the crime that is the object of the conspiracy.

The most effective application of conspiracy law has been in prosecuting organized crime when combined with the Racketeer Influenced and Corrupt Organizations Act (RICO). RICO statutes make prosecution of a criminal organization possible when different members are arrested at different times, but for the same offense, which is evidence of a corrupt organization engaged in a conspiracy with crime as its goal.

## SEE ALSO

Watergate; price fixing; bid rigging; Great Electrical Conspiracy; savings and loan fraud.

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## consumer deaths

CONSUMER DEATHS are those suffered by people as a direct result of using a product they have purchased. When deaths as a result of tobacco- and

alcohol-related diseases as well as from automobile accidents are included, the number of deaths can annually be very high. One report from the Consumer Product Safety Commission listed 4,639 deaths in the United States from October 1999 to September 2000 resulting from household products such as home furnishing and fixtures, and household appliances, with the largest category relating to sports and recreational goods and at an estimated economic cost of more than \$330 billion. By contrast, the World Health Organization (WHO) estimates that 4.9 million people die annually as a result of tobacco use alcohol-related deaths (including drunk-driving incidents) amounted to 33,000 in the United Kingdom (UK) in 2000. Another cause of consumer deaths comes from guns, and WHO estimates in South Africa, for example, 12,000 people were killed by guns, with higher levels of danger in the gun-owner population. These statistics, as well as those in other countries of which they are representative, are frequently contested for political reasons or in attempts to reduce liability.

## CAUSALITY AND LIABILITY

Key issues in the area of consumer deaths include those of causality, that is, did the product itself cause the death or was it a result of misuse or coincidental? Did the company producing the product exercise an appropriate duty of care in ensuring that its products were safe, and had no reason to believe that any dangers were attached to them?

The standards of proof required in courts of law relating to these questions varies from country to country and the litigation process is often intense, because of the emotive nature of the cases and because of the potentially high level of compensation involved. The degree of culpability of the product producers can vary according to the degree to which consumers are expected to understand risks, and to protect themselves accordingly. This creates something of a spectrum of possible cases: ranging from children who are poisoned the toys to deaths from overuse of illegally obtained narcotics, for which there is much less public sympathy.

Nevertheless, when the supplier of a product is negligent in determining whether or not risks are involved with the marketing of goods and services, then the supplier can be prosecuted in most states. Most cases, of course, fall somewhere between the two extremes.

When the drug thalidomide came on the market in 1958, for example, the dangers to the unborn fetus were not recognized during research, and when thousands of children were subsequently born with severe deformities, then subsequent legal discussion centered on the degree to which more care should have been taken to identify possible dangers.

When thalidomide subsequently began to be identified as having additional special medical properties, it was able to be marketed under certain circumstances with its risks properly noted. The energy drink Red Bull was linked to the deaths of three young people in Sweden and has subsequently been banned in several countries. Two of the three people involved had mixed the drink with vodka and the other was said to have drunk several bottles and exercised strenuously. These details have been sufficient to deflect investigations in most countries, since a small amount of risk is considered inherent in any unforeseen circumstance.

On a larger scale, this difficulty of proving liability has been evident in the case of tires for vehicles, and the extent to which accidents may be attributable to them. It is self-evident that there is always a risk attendant upon personal transportation and that driver error is likely to be the highest risk factor, whether to the driver or her passengers or other third parties. Flaws in tires (as in the Firestone case) and other parts of the automobile may be evident without them necessarily contributing significantly to the incidence of death or injury.

Nevertheless, safety experts stress the source of such flaws must be identified and appropriate measures adopted. In an era in which production may be divided between different business units or contracted out to another operator altogether, then it is of considerable importance to identify the source of the flaw, whether in the design process, the production process or some other stage of production.

These complications have made it difficult to secure convictions. Through a combination of imprecision of liability and lack of full legislative cover, in countries such as the United States, business has a strong influence in government, and pressure may be brought to bear to limit liability, despite the clear public interest in ensuring that corporate wrongdoing be prevented. The fragmentation of industries as a result of privatization also makes the maintenance of appropriately high level of safety standards more difficult; private compa-

nies may feel more pressure to show a short-term profit and hence defer investment costs in safety.

Even when appropriate legislation is introduced, it can be very difficult to secure convictions because of the problems of identifying the individuals directly responsible for the deaths. This has been the case when people are killed in transportation accidents, crowd trampling, or fire disasters.

#### SEE ALSO

tobacco industry; healthcare fraud; insurance fraud; corporate criminal liability; defective products; Firestone tires; unsafe products.

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## Consumer Product Safety Act

WHAT RESPONSIBILITY does a company have to inform existing and potential consumers of unsafe products? The Consumer Product Safety Act was enacted in 1972 as a response to perceptions that product liability laws did not sufficiently protect consumers from unsafe products. To implement the act, the Consumer Product Safety Commission was created. The Commission was made responsible for administering additional consumer protection laws, including the Federal Hazardous Substances Act and the Flammable Fabrics Act.

The commission has a broad jurisdiction over items specifically designated consumer products, which are defined as "any article or part produced for sale to a consumer for use in a household, in a school, or in recreation." All consumer products

are subject to the act's mandatory, minimum reporting requirements. Penalties for failing to comply with the act are in place, and include up to \$5,000 per product. Companies may also be subject to criminal penalties if they knowingly commit violations. The act requires that manufacturers, distributors, importers, and retailers immediately inform the commission if any product fails to comply with safety standards, contains a defect that could create a hazard, or creates unreasonable risk of serious injuries or death. If a product is the subject of at least three civil suits within a two-year period, companies are required to file a report with the commission. To protect consumers and avoid penalties, manufacturers must develop policies that enable them to comply with the act.

Estimates in the early 2000s indicated approximately 20 million Americans have suffered injuries from the use of unsafe products. Additionally, of the 20 million victims, 110,000 have been permanently disabled due to unsafe products, while another 30,000 have died. Many researchers studying white-collar or corporate crime have focused their interests on unsafe products in different types of industries. The existing research efforts have provided students in criminology and other fields with a great deal of information on unsafe products and related crimes against consumers.

The potential for unsafe products exists in all industries, although some have received more publicity than others. The automobile industry, particularly Ford Motor Company and General Motors, has been connected to many cases of unsafe products resulting in gross injuries and deaths of consumers. Criminologists have studied the famous Ford Pinto cases of the 1970s, in which the fuel systems burst in read-end collisions. Investigations revealed that Ford was aware of the potential problem during their pre-production stage of the Pinto. Ford estimated that it would cost only \$11 per automobile to fix the problem.

The company's cost-benefit analysis determined that Ford could save \$87.5 million if they kept manufacturing cars that were expected to injure or kill consumers. Ford's rational estimates later proved to be unreliable, as more crashes than they anticipated actually occurred, and many class-action lawsuits against the automaker were initiated. Judgments against Ford repeatedly took place, including a 1978 jury award of \$127.8 million to one teenage victim. Following this particular decision,

the Department of Transportation announced a recall of the Pintos.

#### SEE ALSO

unsafe products; consumer deaths; Ford Pinto; General Motors; Consumer Product Safety Commission.

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## contractor fraud

HOME CONTRACTOR fraud refers to a range of illegal practices committed by contracting firms in repairs and renovations on residential dwellings and financial arrangements associated with this type of work. According to state consumer protection agencies, it ranks among the most common types of consumer fraud in the United States. The most common illegal acts include unnecessary repairs, misrepresentation, bill padding, defective workmanship and home-improvement loan fraud. Such actions generally fall under conventional legal definitions of property theft and fraud, that is, deliberate and deceitful practices intended to gain financial advantage.

Home contracting fraud has come under increasing scrutiny in recent years due to the substantial economic investment Americans make in home repairs. According to the Center for Housing Studies at Harvard University, every year 26 million Americans engage in home improvement projects on their homes, spending in total over \$100 billion. One million of these homeowners spend sums of over \$10,000 on large structural modifications. In



*Unscrupulous home contractors target the 26 million homeowners in America who remodel homes each year.*

addition, the expansion of consumer protection organizations and legislative and judicial initiatives at the state and federal level have drawn significant attention to home contractor fraud. The victims of fraudulent home-improvement work are often elderly and unsuspecting consumers unaware of their legal rights or deceived into unnecessary, overly expensive and often damaging repair work or upgrades on their homes.

According to the American Association of Retired Persons (AARP), certain groups such as older, minority, and lower income persons are more vulnerable to fraud, and are over-represented in cases of illegal home contracting practices. Senior citizens, in particular, are disproportionately represented among homeowners who have accumulated substantial home equity and therefore have much to lose from fraud. Since home repairs and upgrades are usually expensive, they offer prime opportunities for unscrupulous firms that exploit people they see as overly trusting and ignorant of their legal rights.

## THE CONTRACTORS

Consumer advocacy groups have painted a vivid portrait of the typical fraudulent contractor. Often, fraudulent contractors are small-scale and defraud a small number of clients for thousands of dollars. In some notable cases, home-contractor fraud has in-



involved dozens of home owners and much larger sums of money. Many so-called contractors are employees of larger contracting firms who “moonlight” or find work on the side. They are generally not licensed, bonded, or insured. Nor do they belong to a reputable professional association which abides by ethical codes and standards.

Such businesses are therefore often unable to properly obtain legally required building permits, protect clients from sub-contractor abuses, potential liens on homes, and other home-owner legal liabilities, nor provide health insurance and workers’ compensation for those employed on the job. Sometimes, contractors insist clients obtain home-improvement loans from third parties with which they are associated. They do not provide references from former clients, have no permanent offices or contact numbers, accept only cash, demand full payment up front and refuse to enter into a formal written agreement outlining the rights and responsibilities of each party. This suggests that they are a “fly-by-night” operation intent on defrauding clients. Unscrupulous contracting firms solicit door-to-door and offer extraordinary “too good to be true” discounts and guarantees. Consumer groups warn that any or all of the above are warning signals for contractor fraud.

## THE SCAMS

One of the most prevalent illegal acts in home contracting is outright theft of property and money. A supposed contractor knocks at a homeowners’ door offering cheap and rapid work. He claims he needs money for supplies immediately and offers not to charge for the work until the job is completed. After the client provides the money, he simply does not return with the supplies. Occasionally, such contractors begin work on the project before leaving to buy supplies. The homeowner is thus left with damages to the property as well as theft of money. Other typical complaints of this type involve work that was paid for, but never done or equipment that was purchased, but not delivered. Consumer groups state that this type of illegal practice constitutes the most common form of home contracting abuse.

Another illegal act consists of unnecessary or faulty repairs and cleaning done at exorbitant costs. Such contractors solicit clients door-to-door offering to provide a free inspection or cleaning of a part



*Fraud experts advise homeowners to avoid offers made over the phone or that sound too good to be true.*

of the house. Inevitably, costly repairs are found to be necessary. Clients generally have little knowledge of what is actually necessary and fraudulent contractors prey on their fears of potential damages in the event of bad weather or accident. Senior citizens’ organizations have noted that roof repairs and chimney cleaning are frequently the object of such swindles. Contractors claim that new materials or upgrades are needed to avoid dangerous consequences such as fire and structural damage. In the case of chimney repair, some questionable contractors have been known to intentionally damage furnaces, arguing that carbon dioxide is leaking and could lead to fatalities. They then strongly recommend exorbitantly expensive, on-the-spot replacement of “defective” materials. Frequently, the resulting work does not meet industry standards. Victims end up losing substantial sums of money for repair work that needs to be redone.

Another growing type of fraud involves contractors convincing homeowners to file claims with their insurance companies for damages to the home. The contractor approaches clients whose homes require repairs and claims that he can help them get the repairs done at no cost. In these cases, the contractor may create extra damage to certain parts of the home to inflate the insurance claim and then counsels the client to file a claim. The contractor produces a carefully crafted written agreement to perform all the repairs without charging the home-

owner the deductible. This written contract often does not include anything strictly illegal, yet what the homeowner did in filing the claim actually constitutes serious insurance fraud and she is liable in the event of an investigation by the insurance company. Insurance companies have been particularly diligent in recent years and have compiled lists of suspected contractors involved in these schemes.

Contractorfraud.net, a leading consumer rights organization on the internet, has also received numerous reports of fraudulent home-repair activities by groups of so-called travelers, especially in western states. Offering a "great deal" in roofing, painting, and asphalt repair services, it has been alleged they use defective materials and change the size and price of the job without agreement. Property owners who have requested payment by check have been accompanied by the contractors to the bank to cash checks immediately thereby preventing a stop-payment on the check.

Other defrauded clients have stated that they were physically intimidated by the contractors to pay for partial and poor quality services. Illegal schemes like this have affected both individual home owners and small businesses. In one case, a small business owner entered into a verbal agreement for a group of travelers to pave the parking lot of his business. The job was not completed nor satisfactory but the "contractors" demanded payment of \$10,000. The client felt physically threatened and ended up paying them \$1,000 just to leave the property.

Fraudulent home contracting has been particularly prevalent in the wake of natural disasters. Homeowners affected by floods, hurricanes, and tornadoes have been victim to a number of dubious practices. Homeowners in this situation are particularly vulnerable because they require immediate repairs for safety reasons. Numerous cases have arisen of shoddy and/or expensive work by disreputable home construction firms. After heavy storms damaged numerous properties in Mississippi, the state Emergency Management Agency received several reports of fraudulent home contracting schemes.

In a Florida case, a person was charged for impersonating a building inspector who showed up at several homes after a hurricane caused extensive damage to residential properties. The convicted man posed as a state official and ordered immediate repairs which were later done by his own company. In other cases, persons pretending to be govern-

ment officials demanded fees for processing emergency loans documents.

A relatively recent form of home-contracting fraud consists of illegal home-equity loan scams. Nationally, home equity fraud in the 1990s stripped the value from the homes of an estimated 100,000 people in 29 states. Homeowners requiring money for large-scale repairs are able to apply for loans based on the equity of their home. Numerous cases have arisen in which contractors go door-to-door offering to assist clients to acquire the loans, but end up performing poor quality, incomplete, and costly jobs. Worse yet, clients are saddled with expensive monthly payments, high interest rates, and exorbitant financial fees. "Balloon payment" home equity loans are particularly dangerous. These are loan arrangements in which monthly payments are manageable, but the large payment due at the end of the agreement is unaffordable. Sometimes, clients are swindled into offers of further loans to refinance the balloon payment, creating a vicious circle of debt. In many of these cases, the contractor is associated with the lender and receives a fee for finding prospective borrowers. The debt burden for clients has led to foreclosure on some homeowners' properties.

## GOVERNMENT FRAUD

Financial fraud has been especially persistent in the federally financed Title 1 home-improvement loan program. Since the mid-1980s, internal audits within the Department of Housing and Urban Development (HUD) have discovered extensive corruption by home contractors. Over half the applications for this program come from low-income families, many of them senior citizens. This 60-year old program allows contractors, as well as lending institutions, to initiate loan applications for clients ranging from under \$5,000 to a maximum of \$25,000 for home renovations. Home contractors advertise door-to-door or through newspaper advertisements, offering to help homeowners secure loans under Title I.

Commonly, the contractors falsely advertise that loans have been pre-approved and fail to complete work, falsify work as completed, and/or coerce borrowers into claiming that work was completed. Other abuses include working with borrowers to falsify financial information such as income, assets and liabilities; securing loans for

homeowners who do not have the income to repay the loans; and falsifying loan documents to exceed their borrowing limits.

An extensive review of the program in 2002 by HUD highlighted widespread evidence of shoddy work, falsification of documents, over-priced work, and deceptive advertising by home contractors. In addition to the financial damages to home owners, the taxpayer also loses. Each time a homeowner defaults on the loan, HUD is responsible for paying lending institutions. From 1987 to 1996, HUD paid \$114 million in claims on contractor-originated loans. In 2002, HUD initiated a process to abolish the contractor-originated portion of the program due to extensive corruption and abuse by home contractors. New rules limited Title 1 loans to reputable lending institutions.

HUD also publicly named a number of contracting firms that it was prosecuting and penalizing for irregularities and illegal practices. It barred four Texas contractors from doing business with the federal government as a result of investigations. A further 10 contractors in Arkansas, Texas, New Jersey, and Missouri were prohibited for one year from participating in the Title 1 program and levied civil penalties of up to \$5,500.

Two more contractors in Alabama and Denver, Colorado, were barred from launching Title 1 loans. HUD has promised to extend its investigation to other states such as California, Pennsylvania, and Illinois where contractor-originated loans are prevalent.

## PROSECUTION

Until the 1960s, home-contracting fraud was routinely prosecuted under general legislation governing fraud, theft, and breaches of contract. Some illegal practices in home improvements are today prosecuted through legislation governing theft, that is, in the case of building materials or money stolen by contractors. Fraud has gradually come to be defined by courts as an intentional misrepresentation that was relied upon by the plaintiffs and caused them damages. The quality of evidence required to prove fraud, however, differs according to state.

Consumers may also rely on legislation governing contracts to sue contractors for breaching the terms of formal and informal agreements. Verbal agreements for contract work, for instance, may be legally cancelled in all states within three days if the

client notifies the contractor in writing. Yet it can be difficult to prove that an act of misrepresentation was intentional. Moreover, victims of fraud seldom admit it so many cases go unreported. Defrauded homeowners can also rely on general legal protections for all consumers encoded in federal and state legislation. Section 5 of the Federal Trade Commission Act states that "unfair or deceptive acts or practices in or affecting commerce" are illegal and state legislation closely follows these federal guidelines. Most states have passed explicit consumer protection acts (CPA), deceptive business practices statutes and/or home improvement contractor legislation. Others have established compulsory registries of firms engaged in home repairs that can be publicly accessed by consumers. Many CPAs allow plaintiffs to sue for damages and legal fees, but clear misrepresentation or deceit on the part of contractors and clear damages suffered by plaintiffs need to be established. In the absence of written contracts, clients who sue for damages need to provide substantial evidence to successfully sue contractors for compensation resulting from home repairs.

The state of Massachusetts' Home Improvement Contractor Registration Law is a noteworthy example of state-based legislation to combat home-contracting fraud. It was passed in 1992 to reduce illegal practices and provide protection for homeowners. It provides for a state registry of approved contractors whose work and financial practices are guaranteed by the government. Contractors are required to display their license number on all advertisements, contracts, and permits. For jobs over \$1,000, a formal written contract is compulsory. Contractors are expressly forbidden from lending money or to act in concert with lending institutions in cases of home-equity loans. Contractors are not allowed to force clients to borrow from specific lenders if the home is used as collateral.

The legislation also provides for the inclusion of consumer cautions and special notifications such as detailed work plans, a completion schedule, and final cost and payment schedules in all contracts. It offers state-sponsored arbitration to resolve disputes arising between homeowners and contractors. Another important section of the legislation, the Residential Contractors Guaranty Fund, provides for financial compensation for consumers who have been awarded judgements against contractors and have not been paid.

A case from Alabama in 2001 illustrates a typical case of home contracting theft and the resulting legal action. Home contractor, Jack Davidson, entered into agreements with 17 homeowners in Shelby County, arguing that they would be reimbursed for what they paid him for home repairs through an existing nationwide class action settlement for Masonite siding. He solicited money from the clients up front, claiming that he would process their claims in the class action suit and refund their money.

Yet none of the clients qualified for any proposed damages from the class action suit, and Davidson had no connection whatsoever to the case. Moreover, he never conducted the repairs. In addition, Davidson also falsely claimed that he was a licensed and bonded contractor registered with the Better Business Bureau. Davidson was sentenced to prison for first-degree theft and ordered to repay \$247,000 to compensate his victims.

Consumer protection agencies such as contractorfraud.net and state-based Better Business Bureaus provide extensive information on avoiding such unscrupulous and illegal acts, and recommend courses of legal action for defrauded clients.

They generally recommend that homeowners avoid extraordinarily cheap offers; refuse telephone or door-to-door solicitations; carefully check contractors' references from former clients; consult the Better Business Bureau or state registries to confirm that the contractors are legitimate; solicit bids from several contractors; and, most importantly, enter into formal, written contracts, which detail all aspects of the work including costs and payment. In sum, buyer beware.

#### SEE ALSO

Better Business Bureau; scams; insurance fraud; *caveat emptor*.

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## Contra-Gate

WHILE THE arms-for-hostages deal with Iran (Iran-Gate) and the supply of military aid to the Nicaraguan Contras (Contra-Gate) are generally referred to under the umbrella term Iran-Contra, the two distinct events occurred on two separate continents. It was only when the idea of using the proceeds from the Iranian arms sales to provide aid to the Contras, after Congress passed the Boland Amendment banning such action, that the two distinct operations became connected. The cover-up that followed irrevocably tied the two events together in the minds of the American people. By the time all investigations into the Iran-Contra affair were completed, the total cost to the American people reached \$48.5 million.

Iran-Contra is definitely one of the worst foreign policy fiascos in American history. While the administration of Ronald Reagan was involved in damage control, little was accomplished in the area of foreign policy. Even though Reagan was not removed from office, the popular president's reputation was tarnished; and he never quite recovered from the loss of public trust. Immediately after the Iran-Contra scandal broke in November 1986, Reagan's approval ratings fell by an unprecedented 21 percent. When Howard Baker replaced Donald Regan as chief of staff in February 1987, he agreed to accept the position only if he were allowed to conduct an investigation into affairs at the White House. Baker concluded that the president was not in control of the White House or of the executive branch.

#### IRAN-GATE

Until the Shah of Iran was deposed in early 1979, the United States shared an amicable relationship with this oil-producing Muslim country. However, when the Ayatollah Khomeini gained power, the United States became the "great satan" to his followers. In November 1979, 52 American hostages

were taken at the United States embassy in Tehran, the Iranian capital. They were held for 14 months. During this period, President Jimmy Carter banned all trade with Iran. In retaliation for Carter's briefly harboring the ailing Shah, the Iranians refused to release the hostages until Reagan became president at noon on January 20, 1981. Within minutes, the plane carrying the hostages left Iran for Germany. The Iranian government under Khomeini was well known for its aid to terrorist organizations and was thought to be responsible for the taking of additional American hostages on a number of occasions. The Reagan administration emphatically stated that the United States would not trade arms for hostages and would not concede to terrorist demands. In the spring of 1983, the State Department announced Operation Staunch, which was designed to use American influence to keep other countries from selling arms to Iran. Records show that as early as 1981, the Reagan administration was considering selling arms to Iran, even though the White House was well aware of the Iranian connection to the terrorist murder of 241 U.S. Marines in Beirut, Lebanon, and despite the fact that the Iranian government had sanctioned the taking of American hostages and had committed numerous acts of terrorism.

## CONTRA-GATE

On July 17, 1979, the regime of Anastasio Somoza collapsed in Nicaragua, and the National Liberation Front, a communist party known as the Sandinistas, seized power. In February 1981, the Reagan administration announced that it was suspending all aid to Nicaragua. However, Reagan's administration was committed to furthering conservative goals in Central American, and realization of those goals involved supporting rightist governments against leftist governments whenever possible. Reagan decided to increase military aid to El Salvador, Honduras, and Guatemala. His actions in Nicaragua, however, went beyond traditional military aid. Central Intelligence Agency (CIA) operatives were used to train anti-Sandinista or Contra guerrillas and were heavily involved in intelligence initiatives, including mining Nicaraguan harbors.

When Reagan announced that he would support the efforts of the Contras to unseat the controlling Sandinista regime, Democrats in Congress were outraged and pointed out that the human

rights records of the Contras was not much better than that of the Sandinistas. Beginning with an appropriation of \$19 million in 1982, the United States provided the Nicaraguan Contras with \$321.65 million. Approximately \$179 million was earmarked for nonmilitary purposes. The rest was used to fund the Contras' guerrilla activities. After Congress prohibited aid to the Contras, Reagan raised \$44 million from third-party countries and an additional \$10 million from private donors in the United States.

## THE PLAYERS

When Congress prohibited the use of the CIA and the Department of Defense in covert activities, the Reagan administration assigned the job to the National Security Council (NSC). On August 4, 1981, Marine Lieutenant Colonel Oliver North had joined the National Security Council. Two years later, North and his boss Robert "Bud" McFarlane had accompanied former secretary of state Henry Kissinger to Central America. Shortly thereafter, North was designated as "point man" to deal with Contra activities. By summer, Richard Secord had been added to the team. Secord and his partner Albert Hakim, an Iranian exile, created a company, Enterprise, to carry out the covert operations in Nicaragua. Over the 19 months of the war, Enterprise earned \$45 million. While \$15.2 million was used to pay for the arms that were sold, another \$16.5 million was used to fund the Contras. Secord and Hakim netted \$6.6 million from the deal. North reportedly set aside \$4,300 for his personal use.

By 1985, McFarlane reported that he had received authorization from Reagan to begin negotiating an arms-for-hostage deal with the moderates in Iran. The arms were to be channeled through Israel; and by August 20, the first 96 TOW missiles were shipped, followed by a second shipment of 408 TOW missiles on September 18.

Even though no hostages were released, an additional 1,000 TOW missiles were shipped to Iran on January 2, 1986, followed by a fourth shipment of 4,000 TOWs two weeks later and an additional 500 TOWs on February 17. In early October 1986, a C-123 aircraft carrying arms, uniforms, medicine, and other supplies was shot down in Nicaragua, providing a link to the CIA. At the end of the month, an additional 500 TOWs were shipped to Iran. In all,

the United States supplied Iran, the country that most Americans saw as a bitter enemy, with \$12 million in weapons and spare parts, violating arms export laws in the process. In the face of a Congressional ban on funding to the Nicaraguan Contras, millions of dollars had been placed in Swiss bank accounts for use by the Contras.

## THE SCANDAL

On November 3, 1986, *al-Shiraa*, a Lebanese weekly newspaper, broke the story that the United States had sold arms to Iran in exchange for hostages held in Lebanon. Countries around the world denounced the United States, calling the Reagan administration hypocritical for its claims that it would not trade arms for hostages or make concessions to terrorists. Within days, members of Congress were calling for an investigation into North's activities. A week later, CBS aired a report alleging a direct link between the White House and North's activities in Nicaragua.

In his first public statement after the scandal broke, Reagan insisted that *al-Shiraa's* report had "no foundation." This statement was followed on November 13 by the admission that the United States had sold arms to Iran, but Reagan insisted that the claim that arms were sold in exchange for hostages was "utterly false." On November 19, 1986, Reagan held what was surely the most disastrous press conference of his presidency, emphatically denying that a third country had been involved in the sale. He compounded his false statements by declaring that all the weapons that had been sold to Iran "could be put in one cargo plane." Twenty minutes later, the White House issued an official retraction of both statements. Investigators later learned that at this same time North, and his secretary Fawn Hall, were shredding and removing documents from his office as fast as they could. On November 22, Department of Justice officials found the "smoking gun," a memo in which North admitted that profits from Iranian arms sales had been used to fund the Contras.

Once the two stories broke, Attorney General Edwin Meese was told that he had three days to investigate the rumors and make an initial report. As more details surfaced, Meese was afraid that Reagan would be forced to resign from office like Richard Nixon, or even be impeached. Meese's investigation was criticized for being cursory since he took no

notes when he interviewed key witnesses and made no attempt to stop the destruction or removal of evidence. During the November 21 press conference, Reagan's advisers were afraid he would get himself in more trouble with the press and with the public, so the responsibility for damage control lay with Meese who insisted that the president had not authorized the arms sale and that he had not been "fully informed" about what was being done in his name. Meese did, however, acknowledge that the Iranian arms sales had funded the Contras. Within days, John Poindexter, who had replaced McFarlane as national security adviser, resigned from NSC and North was "relieved of his duties." McFarlane who swore that everything he did had been done on the president's behalf later tried to commit suicide. It soon became clear that North had been designated as the fall guy for Contra-Gate. Even so, the scandal raised a general alarm over whether the president was in control at the White House.

## THE INVESTIGATIONS

With Watergate still fresh in the minds of many Americans, the Reagan administration was wise enough to know consequences would be less devastating if the president appeared to cooperate with the investigation, and if he avoided being charged with covering up clandestine activities as Nixon had done.

Three separate investigations into the Iran-Contra scandal took place simultaneously. On November 26, 1986, Reagan appointed a special board, headed by former Texas Senator John Tower, to investigate the activities of the National Security Council staff. Congress also announced that it would open investigations; and in December 1986, a joint committee held closed hearings. Both Poindexter and North initially invoked their Fifth Amendment rights. Yet, because Congress wanted to know the truth, both North and Poindexter were finally granted immunity. On November 18, 1987, the Iran-Contra committee issued a scathing report of its investigation. Congress accused the Reagan administration of secrecy, deception, disregard for the law, pervasive dishonesty, and a "seriously flawed" policy-making process. The committee concluded that Reagan had allowed a "cabal of the zealots" to make major policy decisions. The report issued by the Tower Board was not much better. Tower charged the president with failing to provide

oversight and for being unaware of what was being done in his name. The president, in Tower's view, had failed in his constitutional duties. Tower concluded that North, a "fanciful freewheeler," had engineered the whole Contra-Gate scandal.

On December 19, 1986, Lawrence E. Walsh was named independent counsel and charged with investigating both the sale of arms to Iran and the diversion of funds to the Nicaraguan Contras. Ultimately, Walsh charged Poindexter, North, Secord and Hakim. All five were later indicted on charges that included conspiracy to defraud the United States, obstruction of justice, wire fraud, lying to Congress, and destroying and removing documents. Republicans reacted to Walsh's charges by demanding that he be investigated and accused him of scare tactics with witnesses. They also questioned the money Walsh spent on the investigation.

Poindexter was given immunity in return for testifying against North in the criminal trial. Throughout the investigation, North was pursued more diligently than other defendants. It is hard to imagine that a military officer who had been trained for years to obey his superiors and to act according to a certain chain of command would make decisions of international importance without the proper authorization. North's trial was delayed because of the 1988 presidential election; but on February 21, 1989, North was tried on 16 separate counts and found guilty on three charges dealing with lying to Congress, obstructing justice, and altering, removing, and destroying documents. He was given a three-year suspended sentence, ordered to pay a \$150,000 fine, and sentenced to 1200 hours of community service. Federal appeals courts in Washington, D.C. later overturned the convictions of North and Poindexter on the grounds that congressional immunity had tainted the special prosecutor's cases against them.

In July 1985, Elliott Abrams was sworn in as the assistant secretary for inter-American affairs and soon became involved in the covert operations in Nicaragua. On October 7, 1991, Abrams pled guilty to two counts of withholding information from the U.S. Congress. The following month, Abrams was sentenced to two years probation and given 100 hours of community service. In 1993, Abrams published his own version of the events in *Undue Process: A Story of How Political Differences Are Turned into Crimes*. The choice of book title is indicative of the way that most participants in the

Iran-Gate affair perceived their actions. They saw their legal troubles as a battle between conservatives and liberals rather than as a choice between obeying the laws or choosing to disregard them.

#### GEORGE H.W. BUSH

Even though it was common knowledge that Vice President George Bush, a former CIA director, sat in on all meetings dealing with foreign policy, everyone interviewed in the Iran-Contra affair lost their memories when they were asked if the Vice President had attended a meeting where arms sales to Iran or covert actions in Nicaragua were discussed. The loss of memory was convenient for Bush who planned to run for president in 1988. In the Oval Office, Bush was in an ideal place to put an end to the investigations that had carried over into his presidency. In November 1992, Bush lost the election to Democrat Bill Clinton who, it could be argued, was likely to pursue further investigations into Contra-Gate with enthusiasm. On Christmas Eve 1992, Bush pardoned six individuals who had either participated in the original Contra-Gate affair or who had been indicted for their parts in the coverup that took place in the scramble to save the Reagan presidency. In addition to McFarlane, Abrams, and former Secretary of Defense Caspar Weinberger, Bush handed down Christmas Eve pardons for Duane Clarridge, Alan Fiers, and Clair George who had been charged with withholding information from Congress. Information released after North's diaries were declassified in 1993, led researchers to conclude that the Contra-Gate covert activities were run partly out of the office of then Vice President Bush.

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Bush, George H. W.; Iran-Contra; North, Oliver; Reagan, Ronald; Central America.

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## Coolidge, Calvin (1872–1933)

CALVIN COOLIDGE, the self-effacing governor of Massachusetts, was elected vice president under Warren Harding in 1920. The Harding administration moved into the White House at the beginning of Prohibition, and was plagued by scandals, many still unresolved when Harding died in San Francisco at the end of a presidential tour to Alaska in the summer of 1923.

Whereas Harding had been the choice of the Republican Party bosses and Senate leaders, Coolidge won popular support from the floor of the Republican convention, despite party leaders. To the rank and file delegates, Coolidge seemed an honest, decent, intelligent-minded, and even energetic governor who had few connections with the "smoke-filled rooms and fat cat bankrolls." But in an age of machine politics, Coolidge himself had risen to prominence in Massachusetts under the aegis of the Massachusetts Republican machine. He later prided himself on being "unbought and unbossed." Harding had brought Ohio cronies to Washington, D.C. including his political mentor, party boss Harry Daugherty, whom Harding appointed attorney general. In the midst of Prohibition, alcohol-fueled White House poker evenings were notorious. Corruption brewed in Daugherty's Department of Justice, the Bureau of Investigation, and the Treasury Department.

Charles R. Forbes, director of the Veterans Bureau under Harding, had been caught selling sup-

plies, worth hundreds of millions of dollars, that the government had allocated for the military and veterans' hospitals to private contractors. Harding allowed Forbes to leave the country to escape prosecution, but his general counsel at the Veterans Bureau, Charles Cranmer committed suicide while under investigation, as did Jess Smith, a key member of the Ohio gang and assistant and roommate to Harding's long-time friend, Attorney General Daugherty, after Harding discovered evidence that he had been engaged in influence peddling.

In addition, there were the lingering effects of the Teapot Dome scandal, which focused on Harding's secretary of the interior, former New Mexico Senator Albert B. Fall. The new president appointed two special counsels to investigate the Teapot Dome scandal. Fall was accused of leasing Naval Petroleum Reserves in California and at Teapot Dome, Wyoming, to oilmen Harry Sinclair and Edward Doheny, receiving \$400,000 dollars in return. Prior to the complete unraveling, Fall had gone through what became a common revolving door to a highly paid position with Sinclair's oil company.

Realizing that most of the scandals emerged from the office of the attorney general, Coolidge moved carefully, but finally found an excuse to have Daugherty resign when he refused to provide Justice Department documents requested by a Congressional investigating committee. Thus, through deft political maneuvering, Coolidge had largely defused the Harding scandals in time for the presidential campaign of 1924. Fall, finally convicted of bribery, went to jail, as did Forbes (who had returned to face his own investigation and prosecution). Daugherty was formally censured by the Senate, although his criminal involvement was never conclusive.

Coolidge was nominated to the Republican ticket on his own account, and was easily elected in a three-way race with Democrat John W. Davis and Robert M. La Follette running as a Progressive. Americans were satisfied with Coolidge's pledge of a "return to normalcy."

During his second term, Coolidge presided over a period of rising stock markets and seemingly rising prosperity. He was not a bold man, and this fit his philosophy of limited government interference. He strenuously resisted providing federal relief following the devastating floods on the Mississippi in 1927, which had left 1.5 million people homeless. He reasoned that the Congressional bill provided too



much support to “the railroads and the banks and the individuals that might have invested in levee bonds.” Coolidge continued to resist but finally acquiesced to the creation of what is now the Federal Emergency Management Administration (FEMA), and an important role for the U.S. Army Corps of Engineers in future flood control projects. All in all, it was not what Coolidge did, but what he failed to do, which branded him as a friend of business. He curbed the Federal Trade Commission with pro-business appointments. Under his administration, the hard-fought-for Interstate Commerce Commission languished. His efforts to lower taxes focused on reducing the burden on business and capital, relying on his multi-millionaire Treasury Secretary Andrew Mellon, an industrialist. The final bill actually increased corporate tax rates, but eliminated the gift tax and halved the estate tax.

Coolidge announced that he would not seek another term. As he left office, *The Nation* wrote: “To the businessmen who wanted a moratorium on reform and newfangled ideas and wished to get the government out of business, he has been a god-send.” The author continued to accuse him of “complete surrender of the regulatory powers of the government to the interests to be regulated.”

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antitrust; reform and regulation; Teapot Dome scandal.

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## copyright infringement

A FORM of intellectual property theft, copyright infringement occurs when one party copies another party’s copyrighted material without first obtaining permission. Major challenges for those seeking to enforce laws protecting copyright holders extend from the fact that laws have, over time, become insufficient for conviction within the new global envi-

ronment. Further, the penalties have typically been proven to be an insufficient means of deterring would-be violators. According to legal scholars, (Barr, et al.) this form of intellectual property theft has become so common that civil damages are considered part of the cost of doing business.

Copyright violators pose significant costs to rights holders by cheapening the cost of their product on the open market. Those seeking to hold violators of the law accountable have often encountered challenges posed by questions surrounding the types of material that may be copyrighted, and the flexibility of how illicit use of another’s material is defined. Rapid technological advances and widespread internet usage have introduced new dilemmas for parties seeking to impose penalties upon violators of copyright laws. Recent legislative changes have resulted in a broader definition of material that may be copyrighted, a broader interpretation of infringement, and the introduction of stricter penalties for violating the law.

### COPYRIGHT CRACKDOWN

In the early 2000s, there has been an intense escalation in efforts to crackdown on copyright infringement. However, as the U.S. Constitution granted Congress power over copyright legislation, it attests that this is not a new problem: 1897 marks the year when criminal copyright infringement, as separate from a civil violation, was first introduced into federal law.

Legal scholars (Barr, et al.) detail the evolution of copyright infringement laws and corresponding defensive and offensive strategies used in criminal cases. Conviction on the grounds of criminal infringement is contingent upon the prosecutor’s ability to show that the defendant willfully violated the law and did so for profit. The Copyright Act of 1976 eased the burden on the prosecutor by requiring that she prove that the infringement had been willful and undertaken for “commercial advantage” or “private financial gain” rather than “for profit” alone. Congress increased the penalties for criminal infringement in 1982. In 1992, Congress enacted the Copyright Felony Act in response to mounting complaints extending from piracy of computer software.

This was not the first time that Congress had legislated within the area of copyright infringement due to software piracy. The Copyright Act of 1976

was amended in 1980 to extend protection to software. Yet, software piracy continued to become increasingly widespread, posing difficult challenges to enforcement, and cut into the profits of manufacturers. Scholars who approach this issue from a sociological perspective explain that many people who copy and distribute software are unaware that they are even engaging in an illegal activity. Much of the confusion of what constitutes an illegal use of software lies in the fact that distributors themselves have passed on free trial copies to potential buyers.

The hypothetical scenario that sociologists Anne Christensen and Martha M. Eining present in their study is all too real and familiar. An office worker makes copies of a program licensed for only one computer in her workplace so that she may use it at home to increase her own efficiency. Copies are also passed on to his friends. However, under licensing agreements, the software company actually retains ownership and therefore the right to limit subsequent duplication. Users agree to this arrangement when they open the package and accept the terms when they install the software package on their computers.

Thus, the 1992 Copyright Felony Act broadened protection beyond copyrighted audiovisual materials to include all copyrighted works and lowered the monetary threshold required to bring a criminal, rather than a civil, conviction. In order to achieve a criminal conviction, the burden falls upon the prosecutor to prove the existence of four elements were at work at the time of the defendant's alleged violation of copyright laws. First, that a valid copyright exists must be established.

A copyright is valid only if a certificate of registration has been issued within 5 years of the first appearance of the work. Second, it must be shown that the defendant has access to the work in question and that the copy is substantially similar. The challenge posed here lies in the standards that are used to establish what constitutes substantial similarity. Courts apply different stands in this regard, with some comparing the replicated version in its entirety against the original, and others that separate the copyright-protected components from unprotected components.

Third, the prosecution must show that the defendant intended to violate the law. And finally, it must be shown that the violation was for financial gain or violated the minimum threshold. A threshold violation is established if it can be shown that

the value of the total amount of goods copied and distributed is in excess of \$1,000.

The defense of the accused party is contingent upon ability to establish "first sale," "fair use," or "*scenes a faire*." First sale doctrine asserts that the author of any copyrighted material relinquishes control over subsequent distribution once the first sale of the product has been made. However, first sale does not recognize the right of the purchaser to reproduce and distribute additional copies. This defense is most successfully applied, however, in cases where copies have been imported into the United States.

The establishment of fair use is more vague because the defense must balance the underlying "good" intentions for the reproduction and distribution of copyrighted material against the overall harm that has been done. Questions of whether or not the material was used for educational or non-profit purposes may be examined to determine fair use. *Scenes a faire* may be argued when it can be established that the material in question is so integral to the production of a work falling into a particular category, that no works may be produced without using that same element.

## BREACH OF ETHICS

Copyright infringement represents a breach of ethics through the impact that it has on the community, broadly defined. Copyrighted material represents the intellectual property, often of an individual developer who does not reap the full value of her product through sales on the open market. It has been argued that the savings that accrue to copyright violators are passed on to consumers making legitimate purchases by vendors who estimate the costs of pirated material. Pirated products, such as software, cannot be updated. Entities providing services that are contingent upon pirated products therefore place clients at risk. Individuals using pirated materials within a business environment expose the company as a whole to legal action.

## INTERNET FILE SHARING

Cases of copyright infringement that have captured media attention involve suits brought by the recording industry against internet file-sharers, and a rise in the incidence of publishers suing copy shops lo-

cated near the campuses of major universities. The recording industry filed 261 lawsuits against consumers who shared music over the internet. File-sharing networks, such as Napster, allowed millions of people to trade and download files of copyrighted music free of charge. The magnitude of internet file-sharing poses a threat to recording companies that lose the competitive advantage they have enjoyed over production and distribution.

In an unprecedented move, the recording industry decided to sue a sample of people who had made 1,000 songs or more accessible in folders housed on major file-sharing services. This move represents an effort to stigmatize an activity that an estimated 60 million Americans engage in by labeling it as a criminal activity. It is a strong message to the public. However, it has been pointed out that the recording industry risks alienating the public; increasingly, unmasked offenders have been teens and college students.

In 2003, a crackdown focused on businesses that copy and sell course-packs to college students without first getting permission from publishers. Copy shops in both Los Angeles, California, and Indiana number among those sued in a lawsuit coordinated by the Copyright Clearance Center for copying journal articles and excerpts from books, and then selling the compiled packet without obtaining permission and without paying royalties for that privilege.

#### SEE ALSO

trademark infringement; consequences of white-collar crime; capitalism; United States.

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## corporate criminal liability

THE CORE QUESTION is this: Can a corporation commit a crime? Some insist that the answer should be no. They argue that a corporation is an inanimate entity. It has no mind, no will, and no power to act except through the behavior of people who are in charge of it and those who work for it.

But the answer in the law that prevails in the United States is yes. A corporation may be convicted in a criminal court for acts that violate the penal law of the jurisdiction in which it is tried. The guilty corporation may be punished in a variety of ways: it can be made to surrender the license that allows it to carry on its business; it can be forced into bankruptcy; it can be placed on probation, and, as happens much more usually, it can be fined. The crimes that a corporation may commit include murder as well as offenses of omission, such as the failure to install safety precautions in a factory. A corporation presumably cannot be convicted for rape, and it cannot be imprisoned.

The current legal rules regarding corporate criminal liability came into being after earlier debate about the propriety of criminally punishing a corporate entity. A major argument was that a corporation lacked the required *mens rea* (that is, a guilty mind) that is usually essential for a determination of criminal guilt. John Marshall, an early chief justice of the U.S. Supreme Court, noted that a corporation is "invisible, intangible, and existing only in the contemplation of law."

But arguments opposing inflicting criminal liability on corporations fell piecemeal over the years. Probably the most significant reason was that corporations were more readily identifiable than the humans within them who might have been responsible for criminal behavior. Second, the economic power accumulated by the corporate world seemed to demand that reins be imposed on it to restrain free-wheeling and destructive acts. Also, not insignificantly, corporations typically have deep pockets, that is, a good deal of money from which the state, by means of criminal convictions, can obtain recompense for financial or other harm or costs inflicted by corporate wrongdoing.

#### HISTORY OF LIABILITY

The principle that a corporation can be accountable for the crimes of its agents arose in church courts in

medieval times. The church responded to alleged heresy in corporate bodies, most notably monasteries, by excommunicating them. In the 13th century, however, Pope Innocent IV reversed that trend on the theological ground that church organizations did not possess a soul: they were *persona ficta*, that is, fictitious persons.

In England, financial responsibility first came to be placed on boroughs, regarded as corporate entities since they were chartered by the king, for such matters as failure to keep a bridge in repair.

American courts first placed corporations into a criminal law context in the 1908 *New York Central Railroad* case (212 U.S. 481), an occurrence duplicated in England not long after in *Mousell Brothers* (2 King's Bench 836). In time, the federal legal system and all of the American states came to regard corporations as fair game for criminal prosecution.

Foreign jurisdictions deemed it legally impermissible to charge a corporation under the criminal law until much more recently, but they too increasingly have been falling in line with the Anglo-American doctrine. In 1998, for instance, the Council of Europe recommended that members should consider changing their criminal codes to include corporate criminal liability, and that they should attach four elements to their definition of the offense: 1) the offender's act should be related to his or her employment; 2) liability should attach even if the person who committed the criminal act cannot be identified; 3) the enterprise can be exonerated if "all necessary steps" had been taken to inhibit the behavior; and 4) corporate criminal liability should be imposed in addition to individual criminal liability.

Some scholars believe that the idea of corporate criminal liability was sloppily superimposed on a structure of criminal law that had been built with human behavior in mind, and that a distinctive body of law ought to be established that deals exclusively with corporate wrongdoing. But such a change is unlikely unless a particularly striking situation develops that highlights the inadequacy of the jerry-built laws and court decisions that define corporate criminal liability today.

It is uncertain whether the laws proscribing various forms of activity that are charged against corporations as crimes are effective in preventing such behavior. Research conducted on this subject remains woefully weak. Sally Simpson has observed that the question has never been explored with the use of satisfactory scientific approaches and that

the conclusions that have been published are far from reliable as guides to policy.

The U.S. Sentencing Commission provided the most important recent additions to the debate about corporate criminal liability when it issued guidelines for the judicial disposition of convicted corporate criminals. Penalties were made much stiffer, although the commission was forced by industry lobbyists to back down from its initial attempt to impose even tougher sentences. Penalties under the guidelines may be reduced by cooperation with the enforcement agencies and by demonstration of programs aimed to head off an offense before it occurs. Such mitigation, however, is not permitted if the crime was committed by a senior employee with managerial authority.

A 1995 report indicated that all but a few of the companies sentenced under the new guidelines had been in business 10 or fewer years, and that 97 percent were privately held or controlled by a small group of shareholders. It may be that the debate on corporate criminal liability, which tends to visualize the culprits as being the large and powerful Fortune 500 organizations, is dealing with an issue that is far from the reality of what actually happens. The recent outbreak of cases involving giant corporate business, exemplified by the Enron and Arthur Andersen scandals, may herald a shift in enforcement priorities.

## LIABILITY DEBATES

In the precincts of criminological social science, the major intellectual dispute concerns attempts to construct theoretical explanations for corporate criminal liability. A debate between Donald Cressey, who declared that such explanations are impossible, and John Braithwaite and Brent Fisse, who argued the opposite viewpoint, ended in what many non-combatants considered a draw.

Cressey maintained that it is self-defeating to try to apply social psychological theorizing to corporations because such work "is based on the erroneous assumption that organizations think and act, thus saddling theoretical criminologists with the impossible task of finding the cause of crimes committed by fictitious persons."

"It is time," Cressey insisted, "for criminologists to put their common sense to work when confronting reports that a corporation or other organization has committed a crime." He grants

that it is possible to locate correlations between structural variables, such as a corporation's financial condition and its involvement in criminal actions, but he argues that it is not possible to go beyond such statistical relationships to statements regarding causation.

For Braithwaite and Fisse, a theory need not depend upon what they call "moral personhood," that is, on human beings acting as individuals. They note that the Great Depression can be explained theoretically without any need to find humans who might be said to have caused it. The essence of the Braithwaite-Fisse position is that what corporations do is a composite of individual actions and can be sensibly interpreted as an additive process, exemplified, for instance, by corporate documents. A corporation may engage in a criminal act that no single individual in the organization would personally endorse but which, as a group, employees actually or passively allowed to take place. The analogy is to a lynching mob that carries out acts that no member of the crowd would do alone.

The development of the doctrine of corporate criminal liability has been the result almost totally of expedience rather than reliance on sound empirical information. This is not to say that what has resulted is necessarily wrong or ought to be jettisoned, though many believe otherwise. It is to say that the concept of corporate criminal liability has not been accorded sufficient research attention that could resolve nagging and very important issues. We do not surely know, for example, whether charging a corporation rather than an individual or charging both together dilutes the deterrent force of the penalty or makes no difference. Often prosecutors will ease up on individuals if their corporate employer admits guilt and provides information that could aid in a civil suit by those who were exploited. Is that a good or a self-defeating tactic in regard to deterrence of the wrongdoer and those who might contemplate doing the same thing or another corporate crime? These are matters that await attention by those concerned about the concept of corporate criminal liability.

#### SEE ALSO

Enron Corporation; Arthur Andersen; ethics; Braithwaite, John; Fisse, Brent; Cressey, Donald.

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## corporate dumping

THE PRESENCE of various types of toxic substances in our environment has become increasingly widespread—a fact that former President Jimmy Carter once called "one of the grimmest discoveries of the modern era." Chemical sales in the United States exceed a \$112 billion per year, with as many as 70,000 chemical substances used in commerce. There is no clear-cut definition of what a hazardous waste crime includes, but one definition of a hazardous waste crime is: any act that violates a hazardous waste statute.

The Resource Conservation and Recovery Act (RCRA) of 1976 is the main statute that outlines the various types of activities that are regulated and punishable. Under RCRA, the Environmental Protection Agency (EPA) has defined hazardous waste as any solid waste, or combination of solid wastes, that because of its quantity, concentration, or physical, chemical or infectious characteristics may: cause, or significantly contribute to an increase in mortality or an increase in serious, irreversible or incapacitating reversible illness; or pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported or disposed of, or otherwise managed. (42 U.S.C. '6903 (1983 ed., supp. 1991).

While hazardous waste crimes vary according to local industry or population type, similar methods of operation are used regardless of the type of waste or material involved. One widespread practice involves criminal activity by a generator, transporter, broker, or treatment, storage, and disposal facility. For example, a generator may act alone or conspire with others to illegally dispose hazardous waste, either by on-site disposal or by removal and disposal at unauthorized points. Often, an unlicensed transporter will contact unwitting (or uneducated) generators and convince them that a low-cost disposal strategy is possible. The transporter may conspire with a known treatment, storage, and disposal facility or dispose of the wastes after falsifying the manifests. A less common practice, but one seen in several states, is to rent a truck, fill it with hazardous waste, and then abandon the vehicle.

Perhaps the most common form of illegal disposal of hazardous waste is midnight dumping. In a typical midnight dumping scenario, wastes are disposed of in the nearest isolated area. Agents of generating companies can directly commit these offenses or criminally conspire with waste transporters or treaters who, for a percentage of the legitimate treatment cost, will illegally dump the wastes. In some instances hazardous waste generators are the victims of fraud committed by midnight dumpers; payment is rendered by the generator to the treater for services that are never performed.

### COCKTAILING

Three other common types of hazardous waste crimes include cocktailing, paying illegal tipping fees, and the forging of manifests. Cocktailing occurs when someone mixes hazardous waste with nonhazardous waste in small quantities so that it will pass for a nonhazardous waste. Once the hazardous waste is mixed in 55-gallon drums, county and state landfills should not accept the waste, but many landfills have been caught accepting the waste if the transporter pays the landfill employee a tipping fee to look the other way and/or classify the incoming waste as non-hazardous.

Every shipment of hazardous waste must be accompanied by a manifest. Forging manifests is also common and is mainly done either by the generator or the transporter. Transporters may illegally dispose of some of the waste, then change the amount

of hazardous waste that is shown as properly disposed of on the manifest. This practice allows the generators to have a copy of a legal manifest to show to the regulators while giving the transporters more money because the difference is made up by the illegal disposal of some of the waste.

### EXTENT OF WASTE CRIME

Estimating the extent of hazardous waste crime is conceptually and practically very difficult. To begin, national estimates of hazardous waste generation are highly uncertain. A second obstacle is the various and conflicting definitions of hazardous waste that exist between the federal, state, and local level environmental agencies. Not only are there varying definitions, but there are new chemicals being produced each year that may or may not be considered hazardous according to the different standards. A third obstacle to obtaining accurate estimates of hazardous waste generation is the difficulty in identifying the universe of hazardous waste generators, treatment, storage and disposal facilities, and those who transport the waste.

As of 2003, the EPA estimated that there were 302,283 known organizations handling hazardous waste in America. This does not include many of the small organizations that have not been identified, including the thousands of hazardous-waste producing auto repair shops, dry cleaners, and photo-processing businesses operating in the United States. The major problem of illegal hazardous waste handling and disposal is suggested to be worse among these smaller nonregistered organizations. Lastly, it is also hard to estimate the actual amount of illegally disposed hazardous waste since there are numerous places to dump it without discovery. Even if the illegally disposed hazardous waste is found, it is nearly impossible to identify how, when, and by whom it was dumped. In order to stop the illegal disposal of hazardous waste, it is imperative to understand who is responsible and what motivates the offender(s).

Who are the perpetrators of these crimes? This is a good question, but unfortunately one that has not been subject to much research. There are different types of hazardous waste criminals, and their methods of operation can be very different as well. There are also a variety of reasons why people commit hazardous waste crime. Some people may accidentally, negligently, or unknowingly violate a

hazardous waste law. Others may face a financial crisis in their businesses and be motivated to reduce their operating costs by illegally disposing of their waste. Basic greed is another motivator, and some may intentionally plan to pollute for profit. Some hazardous waste criminals are even business associates or members of organized crime.

It is much easier to identify the victims of hazardous waste crime than the perpetrators, but even this can be extremely complicated. America's vast industrialization has resulted in enormous quantities of all sorts of waste. Hazardous wastes crimes have the potential to cause serious harm to both the public and the environment.

Since the discovery of the infamous Love Canal hazardous waste dump site in the 1970s, the problem and study of hazardous waste has received a great deal of attention by the public and the media. This attention has mostly focused on the possible health effects the illegally disposed waste has had on human life. An estimated 100 billion tons of hazardous waste are produced in the United States, with a majority of it being disposed of in an unsound manner.

## THE HUMAN COST

It is very difficult to estimate the human costs of illegal behavior against the environment. Not only is it hard to find the exact cause of environmentally related health problems, but the ultimate source of existing pollutants can be just as difficult to identify. The common absence of a "smoking gun" in hazardous waste cases complicates the task for prosecutors. While the immediate, short-term effects of hazardous waste crime are often hard to detect, the long-term damage can be very severe. Illegally disposed hazardous wastes can cause serious harm to the environment and human health through contamination of water, air pollution, fires and explosions, poisoning via food chain contamination, and direct human contact.

Hazardous waste pollution has deadly consequences. The dumping of hazardous wastes in lakes, rivers, and streams has a significant effect on the aquatic life residing there. One example of a catastrophic "accidental" disposal of waste occurred in Spruce Creek, Pennsylvania. A pipe from a cattle barn leading to a large manure storage lagoon burst. The contents, high in ammonia, poured into a feeder stream that led to Spruce Creek and killed

approximately 11,640 fish. Contamination of fish can directly impact people. Due to heavily polluted waters in many areas across the United States, citizens have been warned not to eat any of the fish drawn from the polluted waterways.

One of the worst cases of illegal dumping involves a Hooker Chemical plant operating in White Lake, Michigan. Hooker was dumping barrels of hazardous chemicals on company property, which apparently leaked into White Lake, killing scores of fish. During the investigation, 20,000 barrels of toxic chemicals were found. White Lake was found so contaminated that residents were warned not to eat the fish or drink the water. In fact, many of the residents suffered birth defects, sterility, and cancer.

This, by no means, is an isolated incident. There are parts of the United States that are so well known for their high level of hazardous waste contamination that they have been given nicknames like "Cancer Alley."

## SEE ALSO

Love Canal; water pollution; Environmental Protection Agency; Toxic Substances Control Act.

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## corporate raiding

CORPORATE RAIDING refers to two different types of behavior. The first is the situation in which

a company hires away employees of interest from a competing company. Typically, the hiring company is interested in the knowledge and proprietary information that the employee has about the products, and/or financial situation of the company they are leaving. For example, Company A is a software development company, which approaches Mr. G who is a software writer for Company B, a competing software development firm. Company A agrees to pay Mr. G twice his salary at company B if he will move his projects to Company A. While not criminally illegal, this type of corporate raiding may be considered immoral or unethical, as well as civilly liable behavior. News reports suggest that this type of corporate raiding is becoming more common as companies seek newer and better products to boost lagging corporate profits.

The second type of corporate raiding was very popular in the 1980s and 1990s era of corporate mergers and acquisitions. This type of corporate raiding involved investors buying controlling interest in corporations. The raid could constitute a friendly takeover, in which the officers and board of the raided corporation agreed to the merger. The other type of raid was called a hostile takeover, in which the officers and board of the raided corporation would fight the takeover.

#### SEE ALSO

insider trading; arbitrage; predatory practices.

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## corruption

THE GREEK PHILOSOPHER Plato (427–347 B.C.E.) believed that democracies were the "fairest" and "most beautiful" of all forms of constitutional government. However, as discussed at length in his classic work, *The Republic*, Plato also believed that a government ruled by the people would ultimately break down, because jealousy over one another's respective functions within the society, and improper decision making by an uneducated public would

yield chaos, subsequently giving way to a desire for order and stability achievable only through despotism. Similarly, the Roman historian Polybius (c. 200–118 B.C.E.) noted that the "... desire for luxury, bribery for the sake of political power, and the substitution of eagerness for wealth ..." in lieu of wise governance, results in corruption. For our purposes, corruption can be defined as wrongfully using one's influence to procure some benefit for oneself or another person.

Both Plato and Polybius saw corruption as inevitable in nearly every form of constitutional system. Polybius produced a number of important writings pertaining to mixed constitutional forms of governance in an effort to curtail corruption. In fact, history scholar Marshall Davies Lloyd, in his article, "Polybius and the Founding Fathers: the Separation of Powers," goes so far as to attribute America's system of checks and balances (that is, executive, legislative, and judicial branches) to Polybius' works. Yet Plato and Polybius also espouse a certain order to life, and corruption is merely an accepted part of it.

The beliefs of these ancient Greek and Roman scholars are comparable to the values shared in many other cultures. For example, bribery has long been accepted in India as a way of life. In April 2002, a law enforcement officer in Punjab sought to secure a government position for his daughter—hoping that placing her in this job would give him access to increased levels of graft. He attempted to coax the officials who recorded the entrance exam scores into raising her final grade by providing them with a \$100,000 bribe.

Unfortunately (for the police officer and his daughter), he attempted to pay the exam administrators with counterfeit currency and was subsequently arrested. Another example is Mexico, where the public frequently provides government officials with *mordida*—which literally translates into English as "the bite," but more accurately refers to a bribe.

Even within the United States, the "honest graft" era of Boss Tweed and Tammany Hall, in which \$75 to \$200 million was swindled from New York City between 1865 and 1871, or the mayoralty of Boston's James Michael Curley, who was able to build a 17-room home complete with a mahogany stairway and crystal chandelier on a small public servant's salary, are spoken of to this day with a form of renegade reverence.



## THE EARLY REFORMERS

Offenses such as bribery, receiving kickbacks, or exerting undue influence over others have likely existed throughout recorded history. Such acts are not exclusive to Europe, Asia, and the developing nations of the world. More than 100 years ago, many activists within the United States, particularly those who had been previously involved with the Abolitionist movement of the Civil War era began to call for the reformation of government policies and procedures in the areas of public employment, code enforcement, and education.

Joseph Rue's "comparative study of spelling performance by 33,000 students in 1897" was at least, in part, an effort to assess the effectiveness of those employed as public school teachers. The ranks of the public service, including those persons employed in education, engineering, law enforcement, and public health were rife with employees lacking legitimate qualifications or simply functioning as a conduit for graft. Thus was born what authors Frank Anechiarico and James B. Jacobs refer to as the anti-patronage vision of corruption control. Through the development of a merit-based civil service system, the reformers hoped to curtail the spoils system that had become pervasive in public-employee hiring, particularly at the local level.

Prior to the passage of the Federal Civil Service Act of 1883, it was not uncommon for city jobs to be awarded in exchange for cash, gifts, or rendering other services at the ward or district level. New York's subsequent implementation of a civil service program—the first such system in the nation—was designed to provide a mechanism through which "comparative merit or achievement [would govern] each individual's selection and progress in the service, and in which the conditions and rewards of performance contribute to the competency and continuity of the service," explain authors Frank Anechiarico and James B. Jacobs.

Such a system was also desirable because many of those persons employed as safety monitors for food products and medicines had failed to adequately protect public health. Upton Sinclair, an author and social activist wrote his 1904 book, *The Jungle*, about rampant abuses in the meat-processing industry.

Borne from the anti-patronage movement was the establishment of a Progressive vision of corruption control within the United States. Spanning

from approximately 1900 to 1933, the focus of the Progressive movement was to separate public administration from party politics, and to protect the masses from corporate abuses by restoring public trust in those acting in positions of power. One of the earliest reformers was Theodore Roosevelt. During Roosevelt's term as president of the United States (1901-08), he strived to eliminate the spoils system that had become pervasive in public office and to reintroduce competition into the marketplace. In 1903, he tasked Congress with the formation of a Department of Commerce and Labor and a Bureau of Corporations to protect the public against unscrupulous business practices.

In 1906, in response to Sinclair's concerns about the safety of America's meat supply documented in *The Jungle*, coupled with issues pertaining to the quality of drugs being manufactured, and the highly exaggerated claims proffered by the producers of health tonics, salves, and potions, Congress enacted the Pure Food and Drug Act. This act specified that any meat products sold in interstate commerce had to be inspected by federal regulators. Roosevelt's enforcement of the Sherman Antitrust Act against the major railroad operators, United States Steel Corporation, and Standard Oil Company yielded victories for the American public both in terms of value and choice of services.

Succeeding Roosevelt, President William Howard Taft continued to strive for reduced corporate influence in government and fair market competition, resulting in more than 80 antitrust actions being filed during his tenure. Most notably, in 1911, American tobacco was deemed to be a monopoly. Later that same year, "the court ruled that John D. Rockefeller's Standard Oil should be broken up into 33 companies," author Kathryn Rubenstein notes.

Immediately following Taft, President Woodrow Wilson continued the fight to curtail the links between private entities and government policies. Among Wilson's greatest successes was the passage of the Federal Trade Commission Act of September 26, 1914. The act established the Federal Trade Commission, which was comprised of five commissioners—not more than three of whom could be from the same political party. The terms of office for each commissioner were also staggered, thus reducing the likelihood of widespread political influence. Commissioners were prohibited from being involved in any other corporation or busi-

ness. The United States's subsequent foray into World War I brought Wilson new challenges, among them were efforts to curtail corruption in the wartime economy.

Unfortunately, progress in corruption control present during the administrations of presidents Roosevelt, Taft, and Wilson came to a grinding halt during the sordid term of Warren G. Harding (1921–23) and the tepid tenure of Calvin “Silent Cal” Coolidge (1923–29). Harding was an ardent supporter of big business. His campaign promise of “less government in business and more business in government” coupled with his entourage referred to as the Ohio gang—a large number of who were ultimately incarcerated—did not reflect positively on the presidency. Harding was also implicated in two sex scandals. The first involved Carrie Phillips, a German sympathizer during the World War I who attempted to blackmail the president. The second incident involved Nan Britton, 30 years younger than Harding, who alleged that they had conceived an illegitimate child together in a closet of the U.S. Senate prior to Harding's run for the presidency in 1920. Yet it was Harding's connection to the infamous Teapot Dome scandal for which he is best remembered in the annals of government corruption.

#### EFFORTS AT CORRUPTION CONTROL

In 1921, Albert B. Fall, Harding's secretary of the interior, successfully lobbied Secretary of the Navy Edwin Denby to turn over control of the nation's government-owned oil reserves to him. In exchange for \$400,000 in personal compensation, Fall then surreptitiously set up leases with the Mammoth Oil Company owned by Harry Sinclair and Edward Doheny's Pan American Petroleum Company.

Shortly thereafter, Fall's new lavish lifestyle came under public scrutiny. A subsequent investigation yielded lawsuits against the government for illegally obtained contracts. In 1927, “the Supreme Court ruled that the oil leases had been corruptly obtained and invalidated the Elk Hills lease in February of that year and the Teapot Dome lease in October of that same year,” Jimmy Zeck explains. Management of the oil reserves was again returned to the Department of the Navy. In 1929, Fall was found guilty of bribery and sentenced to one year in prison and a \$100,000 fine. Sinclair received a short jail sentence for contempt of court and obstruction of justice. Doheny was acquitted of

bribery charges in 1930. Despite the fact that Harding was never linked financially to the scandal, the incident seriously damaged his ability to effectively govern, and impugned his character and personal integrity even after vacating the presidency.

Succeeding Harding, Coolidge was forced to carry the political baggage of scandals that rocked the former office of the chief executive. When he finally managed to shed off some of the stigma of the Harding administration, Coolidge's efforts at policymaking were heavily geared toward the reduction of taxes and empowerment of business. The majority of Coolidge's appointees did little to bridge the gap between corporate wealth and government corruption. Overproduction of foodstuffs and commodities, overexpansion of credit and soaring levels of personal and corporate debt, coupled with Coolidge's “say nothing” approach to governance ultimately led to an economy on the verge of collapse.

Opting not to run for re-election in 1928, Coolidge bestowed upon Herbert Hoover an unenviable place in American history—the opportunity to largely serve as the fall guy for the stock market crash of October 1929, and the worldwide Great Depression swirling around it. This is unfortunate because Hoover made several lasting and important contributions to corruption control. For example, Hoover served as the Food Administrator during World War I, and worked hard to curtail fraud and abuse in the distribution of foodstuffs, both within the United States and on the war front in Europe. He also served admirably as Harding's secretary of commerce, and called for an investigation of the banking industry, and tighter regulations on how funds could be invested.

Hoover created the Reconstruction Finance Corporation (RFC), which made loans to a variety of businesses and allowed for government scrutiny of the recipients. He reorganized the formerly corrupt Bureau of Investigation in 1924 into what ultimately became the Federal Bureau of Investigation (1935). Lastly, Hoover's establishment of the U.S. Bureau of Prisons helped to professionalize corrections-oriented occupations, ensure humane treatment of offenders, and curtail corruption in America's justice system.

Franklin D. Roosevelt's 1933 election as president of the United States ushered in dramatic changes in the way in which government operated—differences that can still be felt to this day from the

social reform policies emanating from his New Deal programs. Unlike the staunchly pro-business policies of the Harding and Coolidge administrations, or the more *laissez-faire*, or hands-off economic approach touted by his predecessor, Hoover, Roosevelt enacted "... an unprecedented program of government-industry cooperation ..." historian George Burson explains. Yet Roosevelt was much less a progressive than his fifth cousin and former president, Theodore Roosevelt. He saw his mandate within the New Deal to energize private enterprise, and worked to pass a myriad of legislation. Roosevelt's expansion and restructuring of the executive branch during the New Deal, coupled with the infusion of presidential activism created a tone that would remain part of American politics through the administrations of Harry S Truman, Dwight D. Eisenhower, John F. Kennedy, and Lyndon B. Johnson.

As the 1950s and 1960s progressed, and America's fascination with the space race and Cold War escalated, so too did the belief that social problems could be solved through scientific solutions. The Johnson administration's War on Poverty—part of the Great Society vision—was in many respects an extension of Roosevelt's New Deal. The War on Poverty created large-scale public programs in "... federal health, housing, employment, services integration, community planning, urban renewal, welfare, family programs ... [etc.]," explains author Michael Quinn Patton. Along with these new programs came Congressional mandates to evaluate the efficacy of appropriated expenditures. The U.S. General Accounting Office, which had previously focused predominantly on comprehensive accounting, also saw its role expanded to include more analytical and investigative activities.

#### RICHARD NIXON

From his earliest days as president, Richard M. Nixon sought to dismantle Johnson's Great Society vision, particularly the War on Poverty, which had burgeoned since its inception in 1964. His administration also sought to curb abuses in employee labor (for example, high-risk industries such as chemical manufacturing, electroplating, shipbuilding, and construction), which ultimately led to the enactment of the Occupational Safety and Health Act of 1970. The Nixon administration also engaged in some high-profile antitrust actions, includ-

ing *Ford Motor Company v. U.S.* (405 U.S. 596) in 1972, *U.S. v. Falstaff Brewing Company*—at the time the fourth largest brewery in America (410 U.S. 526), and pushed for curbing TV and radio advertising promoting cigarette use (1969) and requiring cigarette health warnings in print media (1972).

Ironically, the ultimate cause of Nixon's failure as president was probably his obsession with control. While he successfully enacted a host of laws and regulations aimed at monitoring the health, safety, and fiscal performance of corporations, he also "...sought, with little subtlety, to circumvent legislative constraint," J. D. Aberbach and B. A. Rockman explain in their book, *In the Web of Politics*.

For example, Nixon was unhappy with the non-partisan, civil service orientation of the Bureau of the Budget—an agency that had been specifically designed to serve as a resource available to the chief executive. In 1970, he restructured this organization into the Office of Management and Budget (OMB).

In doing so, Nixon dramatically altered the orientation of the Bureau of the Budget from a neutral support organization into a tool to be used by the president to monitor agencies in the executive branch and keep senior cabinet officials in check. The approach is consistent with the panoptic vision of corruption control, which relies on "a comprehensive system of administrative/criminal laws... enforced by law enforcement agencies using a full array of investigative tools, including covert operations," according to Anechiarico and Jacobs. Nixon masked his desire for a centralized, tightly controlled executive through a program that he dubbed the Quality of Life Review (QLR). Using his newly reorganized Office of Management and Budget, he was initially successful in keeping agency heads from leaking information on the administration's plans under threat of QLR review.

Nixon had hoped to make sweeping and powerful consolidations of federal law enforcement, investigative, and intelligence functions, and sought to curtail the activities of the Federal Bureau of Investigation to limit its investigative authority in matters pertaining to the Oval Office.

Ironically, the June 17, 1972 Democratic National Committee (DNC) Headquarters break-in (Watergate) perpetrated by members of Nixon's reelection committee actually resulted in a broadening of the FBI's powers to investigate misconduct on the part of senior elected officials, including the

president, and led to enacting the Independent Counsel Act in 1978.

### JIMMY CARTER

Without question, no president in U.S. history has done more to foster and expand the panoptic vision of corruption control (that is, left unchecked, government officials will engage in corrupt and illegal activities) than James Earl Carter, Jr. A former naval officer and agricultural businessman, Carter went on to serve as the governor of Georgia from 1971-75. During his tenure in this position, Carter implemented a financial management system referred to as zero-based budgeting, designed to require state program managers to justify each and every cent that would be expended on public projects (a modified form of zero-based budget was also used during the Carter presidency, but it met with such resistance from both executive branch managers and Congress that it was ultimately abandoned). He also enacted Georgia's first "sunshine" law, which allowed the public to participate in a variety of government meetings, particularly when policy issues were to be discussed.

Yet Carter's most pronounced reforms in public administration occurred in 1978, while he served as the 39th president of the United States. He advocated passage of the 1978 Civil Service Reform Act, which served a dual role as "enhanc[ing] the responsiveness of the higher civil service by allowing individuals to be transferred to other jobs ... to broaden their perspectives or to make better use of their talents ... [and] to provide incentives for recalcitrant or difficult individuals to leave the civil service," according to Aberbach and Rockman. The Civil Service Reform Act (CSRA) of 1978 also established a new tier of federal employees, referred to as the Senior Executive Service, designed to hold top executive branch agency managers and administrators "accountable for individual and organizational performance," explains the Office of Personnel Management.

Carter's belief in the panoptic vision of corruption control led to the passage of the Inspector General Act of 1978. Inspectors general (IGs), are non-partisan, independent managers who examine programs in which federal monies have been expended. Specifically, IGs are concerned with issues of waste, fraud, and abuse. Cabinet-level IGs are nominated by the president with the advice and

consent of the U.S. Senate. Inspectors general can also be appointed to serve at individual agencies within the executive branch. The head of the respective agency can make such appointments. Cabinet-level IGs can only be removed by the president.

To fulfill their responsibilities, each office of the inspector general retains criminal investigators, auditors, program analysts, information technology specialists, and support personnel. IG findings can be used in the criminal prosecution of corrupt officials, to assist agency heads or cabinet-level officials in determining if an employee disciplinary action is warranted, and to aid Congress in determining future funding for executive branch programs based on their relative effectiveness and efficiency. In order to enhance the likelihood that incidents of waste, fraud, and abuse will be reported to IG Offices, both the 1978 Civil Service Reform Act and the Inspector General Act include whistleblower protection provisions for those employees who report illicit activities. Whistleblower protections for federal workers and government contractors were further enhanced in 1989 and 1994, when the definition of reportable activities was broadened, and remedies for reprisal against whistleblowers were expanded.

The Office of the Special Counsel (OSC), which is also an independent federal investigative and prosecutorial agency, further protects workers from reprisal if they have reported acts of waste, fraud, and abuse. One of the most important facets of the Inspector General Act was that its authority applied not only to federal agencies, but also to the myriad of programs funded with federal monies. Accordingly, state and municipal projects funded through government grants also began to see the influence of Carter's policies, including audits and investigations conducted by the federal inspectors general, largely in the areas of housing, health and human services, education, and environmental protection.

### THE REAGAN-BUSH YEARS

In the slightly more than 100 years that America has wrestled with various corruption control strategies (that is, anti-patronage, progressive, scientific administration, and panoptic) no period was as wanting of efforts to curtail such acts as the 12 years that Ronald Reagan and George H. W. Bush served as chief executives. The Reagan and Bush administra-

tions were rife with scandals, and correspondingly deficient in their efforts to combat them. Summarizing the research of Shelley Ross in their 1998 book, *White-Collar Deviance*, authors David R. Simon and Frank E. Hagan conclude the following about the Reagan years: "Between 1980-88 over 200 Reaganites came under either ethical or criminal investigation, the greatest number of scandals in any administration in American history." Scholars Stephen M. Rosoff, Henry N. Pontell, and Robert Tillman keenly observe that "one of President Carter's last official acts was the issuance of an executive order toughening the notification requirements for companies wishing to export products whose use is restricted in the United States. One of President Reagan's first official acts was the immediate revocation of the month-old Carter order."

From Iran-Contra to Wedtech, to the collapse of the Bank of Credit and Commerce International (BCCI), and the savings and loan scandals, neither Reagan nor Bush effectively developed any significant corruption control policies. Like Nixon, Reagan used the Office of Management and Budget (OMB) as both carrot and stick to reward loyal administrators with substantial budgets, and punish those who disagreed with his policies by requiring that their agencies perform comprehensive cost-benefit analyses and functional program reviews to the satisfaction of OMB.

In many ways, the first Bush administration was more ambivalent than the Reagan White House. Bush complained publicly about being chided for lacking "that vision thing." Were this not enough of a challenge, a soft, but steady rumbling of questions began to emerge about Bush's three sons. John Ellis "Jeb" Bush of Florida had defaulted on a \$4.6 million loan from the Broward Savings and Loan, and both of his business partners had been involved in other savings and loan misuse schemes. Neil Bush, the director of the Silverado Savings & Loan, had made a series of bad loans in excess of \$100 million to two of his business partners. Ultimately, the Denver-based savings and loan failed, and the fall-out cost U.S. taxpayers more than \$1.3 billion. Lastly, in 1984, George W. Bush had managed to merge his failed Arbusto Limited with the Spectrum 7 Energy Corporation.

Ultimately, the company was blended into Harken Energy Corporation in 1986, and George W. Bush was given 212,000 shares of stock and a directorship with the Dallas-based corporation.

George W. Bush cashed out his stock at a 250-percent profit just weeks before severe corporate losses were announced.

## "REINVENTING GOVERNMENT"

Many people equate corruption with President William J. Clinton. After all, there were such events as the Monica Lewinsky scandal, Whitewater, Travelgate, the Democratic National Committee donations, the Lincoln Bedroom debacle, and appointing Hillary Clinton as "Healthcare Czar." In reality however, for all of the millions of dollars spent investigating these incidents, little actually came of them. Clinton did perjure himself for which he was ultimately fined and disbarred in Arkansas (similarly Nixon was disbarred in New York and former Vice-President Spiro Agnew lost his law license in Maryland); he did engage in "sexual relations" with Lewinsky—although he was not intimate with a German sympathizer during wartime nor did he allegedly sire a child in the Senate cloakroom as Harding had purportedly done) and Independent Counsel Robert Ray found insufficient evidence existed to support allegations that Mrs. Clinton had acted improperly by firing seven employees.

Similarly her participation in the health care reform-working group did not constitute nepotism on the part of the president. Perhaps the most important—and least investigated of the Clinton incidents involved "illegal campaign contributions... and the possible give-away of classified material to the Chinese Army (again, for campaign contributions)," according to Gary W. Potter and Michael D. Lyman. Yet neither political party wished to delve too deeply into this issue given the prevalence of questionable campaign funds in major federal elections. Clinton's presidency was a hybrid of social activism, program review techniques, and fiscal restraint. Reinventing government, later referred to as the National Performance Review (NPR), was undertaken with the stated purpose of "cutting red tape, putting customers first, empowering employees to get results, and cutting back to basics," explain Aberbach and Rockman. Elements of the NPR are similar to the progressive vision—hire good people, give them the flexibility to perform their jobs effectively in the best interest of their customers, and reward them based on merit.

However, Clinton also imposed panoptic styles of corruption control during his eight-year tenure

as president, such as strengthening protections for inspectors general from administrative allegations (Executive Order 12993 of March 21, 1996), and allowing the office of special counsel (OSC) greater investigative authority (for example, permitting the OSC to investigate whistleblower complaints filed by Federal Aviation Agency personnel, and extending whistleblower authority to military personnel). Lastly, the Clinton administration aggressively employed anti-patronage-era techniques by encouraging IGs and other investigative agencies to make widespread use of the False Claims Act to deter future acts of Medicare and Medicaid fraud.

While some of Clinton's ideas may have resulted in streamlining government operations such reforms may also have had adverse effects by eliminating crucial checks and balances in government purchasing prevalent in the scientific administration era. Similarly, NPR's objective of eliminating 272,900 federal jobs likely impacted the executive branch's ability to monitor contractors and detect fraud in government programs.

#### GEORGE W. BUSH

In 2003, the George W. Bush White House appeared to be leaning toward the panoptic vision. Based on his steadfast support for strict penalties for corporate fraudsters, Bush quietly repealed the majority of tough corporate penalties found in his SEC reform during the summer of 2002. Similarly, Bush pushed to ensure that the new Homeland Security Department would not include whistleblower protection provisions for its workers, and that personnel would serve as excepted-service employees, thus affording them far less protection than career federal employees. Lastly, Bush, as with all of the former presidents and Congresses in American history, has been unsuccessful in producing a unified definition of corruption, neither does one exist in the U.S. Criminal Code. Whatever methodology for corruption control a president selects, the cyclical nature of corruption, as accurately predicted by Greek and Roman philosophers more than 10 centuries ago, suggests that efforts to eliminate such crimes will likely prove elusive at best.

#### SEE ALSO

government contract fraud; government procurement fraud; Teapot Dome scandal; Whitewater; investigation techniques; United States; graft.

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## Corvair

THE CHEVROLET CORVAIR was manufactured by General Motors (GM) beginning in 1959 with the release of a 1960 model. The Corvair was unique for its time in that it was small and lightweight, with an air-cooled and rear-mounted engine and a swing-axle independent rear suspension. The design of the car led some to state that the Chevrolet Corvair was an unsafe vehicle that was prone to over-steering and flipping.

At one point, Chevrolet was facing well over 100 lawsuits dealing with damages or injuries to owners of Corvairs. It was these court papers and depositions that would become the bulk of the re-



*The Chevrolet Corvair, produced by General Motors, drew public attention to automotive safety.*

search for a young, unknown attorney named Ralph Nader. In 1965, Nader released his research on automotive safety in the form of a book entitled *Unsafe at Any Speed*. Nader claimed that the Chevrolet Corvair was the epitome of automotive disregard for safety.

It is worth noting that the Corvair was not the only car that Nader criticized in his book. In fact, the Ford Mustang and all models of Cadillac were also criticized. It was the Corvair, however, that Nader devoted the majority of his book to, as evidence of the design flaw in the Corvair pointed to the large number of lawsuits pending against General Motors. These arguments were furthered when the 1964 and 1965 Corvairs were released with improved designs.

Still unsatisfied with General Motors' handling of the situation, Nader criticized the company for not recalling the more than 1 million automobiles that had been sold prior to the redesign of the car. Due to Nader's statements, many consumers developed the perception that GM was greedy and that its only concern was for profits.

Using the fame generated by his book and by his testimony before Congress on automotive safety, Nader became a well-known advocate for change in automotive safety and the Chevrolet Corvair became known as the car that was unsafe at any speed. Today, there are still Corvair-owner clubs and many who believe that the criticism generated by Nader was ridiculous, and that the car is as safe as any other car manufactured during the same time

period. Nader has apparently softened his stance, as he has even spoken at annual Corvair-owners meetings in recent years.

#### SEE ALSO

Nader, Ralph; *Unsafe at Any Speed*; General Motors; unsafe products; automobile.

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## counterfeiting

COUNTERFEITING HAS two branches: the forging of coins and the forging of banknotes or bills. As the history of coins begins much earlier than the production of banknotes or bills, the forging of coins has a longer tradition dating at least back to antiquity. The forging of coins needs some special knowledge of metals and the ways of crafting such materials, whereas the counterfeiting of banknotes or bills necessitates know-how about paper production (including watermarks) and about several forms of printing.

Very early in both coin and banknote history, measures were taken by the legitimate issuers of such items to protect these precious objects against forgery and fakes. Coins often have special corrugation or coinage of the edge, which dates from the time when coins had a value not only defined by their denomination, but by the actual content of precious metal. By doing so, the issuers prevented the clipping by shaving or trimming of the coins. Paper money is even more difficult to protect. Special care was soon taken with the paper, the printing process, the watermarks, and in more recent time, with the holograph. A special identification tool for the issuer is the individual code given to every banknote.

But as the techniques employed by the issuers of coins and banknotes progress, so do the counterfeiting skills of the forgers. Also, the quality of counterfeits helps the forger to delay or to compli-

cate its detection; the decisive factor is always the best way to get those counterfeits in circulation. The emergence of high quality laser printers and color photocopying machines has aggravated the problem of counterfeit banknotes of primitive or modest quality and large quantities. On the technical level there is a (sometimes overlapping) distinction between complete forgeries and falsifications, whereby the latter may signify that only a denomination of a real banknote was altered, or the raw materials and techniques of the legitimate production process of coins were illegally used to produce counterfeits.

## MOTIVES

The basic question for the study of counterfeiting is not how to detect forged coins and banknotes, but find the reason why people forge such items in the first place. Greed as a personal motive may be an explanation in some cases, but, in fact, when structuring the main motivations for counterfeiting one has to keep in mind criminal, social, political, and economic motives.

The main groups of counterfeiting motives could be defined as follows: Counterfeits by criminal individuals or groups (organized crime) damaging to the issuer and the innocent person who gets the forged item without knowledge; the issuer itself produces counterfeits of its own products to cheat the recipient (especially with coins of precious metals suddenly produced with less material, or of not-so-precious metals without announcing this deterioration to the recipient); "counterfeits" of regular money by local authorities to have sufficient numbers of coins and banknotes in circulation at a moment when the centralized, legitimate issuer, for whatever reasons, is not able to provide sufficient stocks of money to keep the economy running; counterfeits as a ruse of war against an enemy, whereby the authorities of one belligerent secretly produce the currency of the foe to undermine the economy of the enemy, or to pay for war needs on the markets of third countries; counterfeits of rare coins and banknotes, whereby the damage is not done to the former issuer, but to the modern collector of coins and banknotes or bills.

Counterfeits by criminal individuals or groups is not only the oldest form of counterfeiting, but most people, at least unknowingly, come in contact with these counterfeits at several occasions during

their lifetimes. The list of names of famous forgers is long: the German Karl Peglow and the Polish-born Frenchman Czeslaw Bojarski, to name only a few.

In a class by himself, is without a doubt, Arturo Alvez Reis, who did not forge money himself but tricked the famous British banknote printer, Waterlow, with forged orders to print Portuguese currencies for him. The printer thought Reis was executing an official order by the authorities in Portugal. Reis founded a bank to distribute these "official" counterfeits and nearly managed to buy the Bank of Portugal when the scandal broke in December 1924.

## ISSUERS

Counterfeits by an issuer producing fakes of its own products to cheat the recipients were common from antiquity well into the 19th century. Coins of precious metals were produced with less precious metal, or less valuable metals without announcing this deterioration to the recipient. This form of cheating was only possible as long as the value of coins was not so much determined by their denomination, but by the actual value of the precious metal of the coin. When the denomination was no longer officially equivalent to the value of the metal, this form of counterfeiting ceased.

One could argue that fraud became even easier for the issuer as it only had to issue larger quantities of coins or more often banknotes and bills, which had virtually no material value compared to their denomination. Inflation created by the issuer (which in modern times nearly exclusively is the state) allowed it to get rid of state debts at home and abroad. Although there were other reasons for the hyperinflation in Germany in the 1920s, the monetary chaos was partially produced by the state printing more and more increasingly worthless notes.

More sophisticated were cheating systems, for example, in former Eastern Bloc communist countries: The state had the monopoly for changing currencies within those countries, and to set an exchange rate fixing its own currency at a fantasy rate against Western currencies like the U.S. dollar or the German mark. Any currency trade by private persons without using the official exchange bureaus was prohibited. Foreign visitors and tourists were forced to buy such bad currencies at an unreasonable price (often enforced by a certain amount of



money which had to be exchanged for each day spent in those countries without the possibility of re-change after the visit, because the export of such Eastern currencies was prohibited).

For example, the official East German exchange rate for the East German mark was 1-to-1 for the West German mark, whereas with traders in West Berlin (seen as criminals by the East German authorities) the exchange rate ranged approximately from 3-to-1 to 15-to-1 or even more extreme. Citizens of Eastern Bloc countries were usually prohibited or restricted from owning Western currencies. This case illustrates that counterfeiting, in a broader sense, is possible without forging or faking a single coin, banknote or bill.

### CIRCULATION

A currency before the age of electronic cash had not only to be guaranteed in value by the precious metal or the issuer, but, what was sometimes even more important, it needed to be to be available in sufficient numbers of coins and banknotes in every place of the region of its official or unofficial circulation. The problem still arises in high-inflation countries today, where sometimes stamps are used for trade because of the lack of sufficient numbers of small denomination coins. In time of war or internal crises, local authorities, small businesses or even private persons often have produced money of their own, which may have infringed the issuing monopoly of a ruler or a state.

Usually those issues are clearly distinct from the regular issues, but in certain cases imitate those regular issues and are thereby not by intent, but *de facto* "counterfeits." It could be argued that the issuing of money by local authorities or individuals to have sufficient numbers of coins and banknotes in circulation at a moment when the centralized legitimate issuer is not able to provide sufficient stocks of money is a good thing, because it keeps the economy running without doing too much damage to a currency already in trouble.

The problem was a permanent one, for example, in early American history. In the colonial era, there was no general currency available except a mixture of European currencies (especially from Britain, Spain, and France) and of local issues of the colonies. This diversity in itself was an invitation for counterfeiters, because the knowledge of currency values required more than a basic education



*The U.S. Treasury authorized changes in the early 2000s to the design of banknotes to foil counterfeiters.*

of precious metals values. Although tough and harsh laws against counterfeiting were in place in the colonies, the necessary control and enforcement agencies usually were not available or insufficient. Personal greed and criminal activities were the motives for most counterfeits in this period, but it could be argued in boom times, counterfeiting actually helped the development of the economy, otherwise a lack of coins and banknotes may have virtually halted trade. This was true only as long as the receiver of a counterfeit was able to pass it on either because of general acceptance of counterfeits as currency, or because of non-detection.

### RUSE OF WAR

Counterfeits, as a ruse of war or as an unconventional method of warfare, used against an enemy

involve one belligerent secretly producing the currency of the foe to undermine the economy of the enemy, and/or to pay for war needs on the markets of third countries. Frederick the Great of Prussia and Emperor Napoleon of France are reported to have ordered, on a large scale, such practices during their various campaigns. One case of peacetime counterfeiting is the attempt by extremist elements of the Hungarian government to forge French francs during the 1920s. The Soviet Union allegedly produced forged dollar bills at the same time, but the real story behind this suspicion still remains sketchy.

A more certain case happened during World War II, when the Nazis decided to produce forged foreign currency (especially British pound notes) on a large scale (Operation Andreas). By 1942, the production of forgeries was transferred to workshops constructed inside Sachsenhausen concentration camp to increase the output (Operation Bernhard, as the SS officer in charge was Bernhard Krueger). In Sachsenhausen, all sorts of Allied documents were forged, but especially British pound notes, and from late 1944, U.S. dollar bills. It seems that the forgeries were first intended as leaflets for air-dropping over Britain, but later were used for financing Nazi foreign intelligence operations. At the end of the war, a large quantity of forged banknotes was dropped into Lake Toplitz in Austria. Several diving expeditions recovered remains from the lake in the Alps during the past 50 years. During the early Cold War, the Soviet Union and the United States accused each other of secretly continuing the Nazi forgery project. It may be that only the North Koreans, in fact, engaged in such an operation; forged dollar bills have been linked on several occasions to North Korean diplomatic officers.

## COLLECTORS

A special case of counterfeiting is the forgery of rare coins and banknotes to the detriment of the collector of such items. Collecting all sorts of things became fashionable during the Enlightenment period, and soon the supply of sought-after rare coins from antiquity (especially Greek and some Roman coins) could not fulfill the demand. One case was the forging of rare German coins from the 1950s, which happened in the 1970s. In this case, persons employed at the Karlsruhe mint (at that time one of the four West German mints),

on the order of an official of the federal ministry of finance, re-used production tools to make unofficial new editions, and sold them with the intention to deceive collectors. Sometimes the value of fakes of high quality and by famous forgers surpasses the value of the real thing. It must be pointed out that not all reproductions of ancient coins in the 18th and 19th centuries were intended as fakes. Many were produced and sold as reproductions, so the customer knew exactly what was being bought. In the process of reselling, this knowledge sometimes vanished by neglect or intent, whereby the reproductions suddenly functioned as counterfeits to deceive collectors.

Apart from the protective measures described above, the issuers of currency always tried to prevent forgeries by the threat of punishments. From antiquity to early modern times in many countries, the death penalty was the customary punishment to deter potential forgers. Today, harsh prison sentences are a regular conclusion of criminal law. In most countries, the police, in combination with experts of the national bank or the issuing authority, are in charge to investigate and to prepare prosecution. The rationale in most countries is the legal, sometimes constitutional, bond between the right to issue currency and the sovereignty of the state.

In the United States, this was fixed by the Legal Tender Act of 1862 and, consequently, the Secret Service as an agency of the Department of the Treasury was founded in 1865 to fight against counterfeiting (after the William McKinley assassination in 1901, the duty to guard the president was added). It should be mentioned that most factors about counterfeits of coins or banknotes are applicable to postal stamps, duty or tax stamps, ration coupons in wartime, and other money substitutes. The age of electronic cash has opened up new ways of cheating, which may, in the long run, be more important than the traditional craft of counterfeiting. Also, the forgery of branded articles as a form of modern "currency" may well surpass the economic damage of money counterfeiting.

## SEE ALSO

forgery; World War II; bad checks; currency fraud.

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## credit card fraud

THE CREDIT CARD has been around since 1958 when the Bank of America issued BankAmericard, which was the first revolving-credit card with universal merchant acceptance. The card started in California but grew from there. In 1966, Bank of America expanded its bankcard program by forming the BankAmericard Service Corporation. This licensed banks outside of California allowing them to issue cards to their customers.

By 1969, most regional banks converted their independent programs to either BankAmericard or Master Charge (now known as Visa or MasterCard). By 1970, more than 1,400 banks offered one or the other credit card. Today, Visa has more than one billion cards in use. Adding another 500 million of MasterCard users brings the total to 1.5 billion credit cards used annually. Seventy-one percent of all credit cards in circulation worldwide are issued in the United States.

In the early 1970s, customers used a credit card through a slide machine, which processed the credit card number leaving a receipt for the merchant and a carbon copy for the customer. Today, credit cards are used electronically, and the information is processed in a matter of seconds. From the beginning of manual machines to the modern electronic processors, credit cards have been used fraudulently. Any person who, for obtaining anything of value with intent to defraud, uses a credit card that has been revoked, cancelled, reported lost or stolen commits credit card fraud. Using the credit card

number without possession of the actual card is also a form of credit card fraud. More recently, stealing a person's identity in order to receive a credit card is another more threatening form of credit card fraud, because it works in conjunction with identity theft. Credit card fraud is a problem that affects the entire consumer credit industry. It is one of the fastest growing types of fraud and one of the most difficult to prevent.

Credit cards are an integral part of the American economy and their use is increasing worldwide. The extensive use of credit cards, however, has its drawbacks. Credit card fraud is primary among these problems. Across the globe, credit card fraud losses to Visa and MasterCard alone have increased from \$110 million in 1980 to an estimated \$1.6 billion in 1995. At this rate of growth, it could grow to well over \$30 billion by 2005. Credit card fraud has and will continue to increase mainly because of the ease of committing it. The biggest victim of credit card fraud is the financial institution and bank card company, but individuals are also victimized, mainly through identity theft or bad credit ratings. While losses to Visa, MasterCard, Discover, American Express and the institution issuing a credit card mount, several schemes have been identified.

### DUMPSTER DIVING

One of the earliest ways of committing credit card fraud was either by stealing the card from someone's wallet or by "dumpster diving" for carbons. These two ways have decreased with the advent of computers and electronic processing of credit cards. Now, one of the simplest ways to obtain a person's account information or actual credit card is through postal theft. Many people put their mail in their mailbox and raise the flag letting the postal worker know that there is mail to be picked up. Unfortunately, this also is a telltale sign for a fraudster. At the end or beginning of each month, many customers mail their bills, including credit card payments. Any person who steals the mail may now have access to personal information, including credit card account numbers, credit limits, and banking information. The fraudster can use this information to obtain additional cards or create new accounts without the knowledge of the true owner.

Advance payment schemes are also prevalent. Federal consumer credit regulations require that credit card issuers credit a customer's account as

soon as payment is received. This is now possible instantaneously since most transactions are electronic. Using a counterfeit or stolen credit card or credit card number, a fraudster either makes an advance payment on the card or overpays an existing balance using a counterfeit check. Because the account is credited upon receipt of payment, cash advances can be immediately drawn against the credit card before the payment has cleared. A fraudster can clear millions of dollars this way and it will go undetected until the next bill arrives.

### COUNTERFEIT CARDS

The fastest growing type of credit card fraud is the counterfeiting of Visa and MasterCard. New technology has aided criminals, with relative ease, in the production of existing credit cards and the creation of fictitious cards. Fictitious cards are more advantageous because there is no person truly responsible for the account. The credit card companies will notice that the account is not being paid and they will attempt to contact the account holder, but no one will exist.

The internet has helped this scheme to grow and some organized criminal groups are becoming very efficient at this activity. Counterfeiters sell the magnetic strips or the technology to duplicate the information from a valid credit card. These magnetic strips contain all the information a fraudster needs: names, account numbers, credit limits, plus other identifying information. Using a computer system and the right equipment, a counterfeiter can create a fraudulent credit card with ease.

Many financial institutions have also benefited from new technology in the creation of security features. Holograms were the first to be created as a fraud deterrent, but this does not stop fraudulent spending over the internet or in situations where there is no "gatekeeper." A store clerk is supposed to know that the credit card is fraudulent, but with so many banks and other financial institutions in the credit card industry, it is impossible for a clerk to know which cards are fraudulent.

Clerks are supposed to check the signature on the back of the credit card, but most do not even conduct this simple task, let alone examine the hologram or other safety features. With the increase of shopping by mail over the telephone or the internet, fraud has increased exponentially. There is no clerk to check the credit card in these transactions.

This creates an almost anonymous atmosphere where using fraudulent cards or numbers is easy.

One of the problems surrounding credit card fraud is the ambivalence of the consumer. Credit card agencies advertise a zero liability for credit card fraud. In some cases, a \$50 fee may be incurred, but this may also be waived. If someone's credit card is lost or stolen and it is reported, then the customer is not responsible for any fraudulent charges. It is relatively easy to know if your card has been lost or stolen; you are no longer in possession of it. However, if your credit card number has been stolen and duplicated, this is not apparent until a bill arrives with the fraudulent charges. Some criminals will even go as far as to change the mailing address on the card to avoid being caught by the consumer, thus extending the time the card may be used. Many criminals, though, will simply use the number to apply for a new credit card, one that is attached to your name, although you would be unaware of its existence.

It is true that a person may have little if any liability if his or her credit card or number is used illegally, but what most of the television commercials and credit card institutions fail to tell consumers is the hassle that is related to having your credit card used fraudulently. When a credit card is issued in someone's name, this appears on his or her credit report. If that credit card is then used fraudulently, this also appears on the credit report and this has some very serious consequences, especially if the card holder is completely unaware that an account has been opened.

Collection agencies and creditors will be looking for payment, thus looking for someone to make those payments. Most people do not even realize that there are other accounts opened in their names until they are ready to make a large purchase, like a car or house for example. A routine credit check is done and consumers are surprised to be turned down for a car loan or mortgage because of their "bad" credit. If this does occur, then it is the consumer's responsibility to clean his or her credit report, even if he or she can prove he or she never made any of the suspect charges.

The Fair Credit Billing Act (FCBS) established procedures for resolving billing errors on credit card accounts. It is the consumer's responsibility to contact the credit agencies in order to take advantage of the law's consumer protections. In many instances, it takes years for the credit agencies to

investigate the fraudulent activity; in the meantime, the car loan or mortgage may be delayed or outright denied. One of the best preventive techniques to keep a credit record safe and clean is by contacting the three credit agencies and reviewing credit reports on an annual basis. (The three agencies are: Equifax Credit Information Services, Experia, and Trans Union.)

#### SEE ALSO

internet fraud; telemarketing fraud; wire fraud; scams.

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## Crédit Lyonnais

THE FRENCH banking giant's bailout of California-based Executive Life Insurance Company (ELIC) was called "superb" by state officials in 1991, but by 1999 investigations revealed a scheme by which the bank profited through concealed ownership. Like many 1980s investors looking for dramatic gains, ELIC had invested heavily in junk bonds: high-yield, high-risk bonds issued by companies that are likely to default. Using junk bonds to fund corporate takeovers and restructuring had fueled the rise of investment house Drexel Burnham Lambert, which sold ELIC much of its portfolio. After Drexel Burnham collapsed, so did ELIC's investments, resulting in the largest insurance company failure ever.

California Insurance Commissioner John Garamendi chose Crédit Lyonnais's offer over that of a San Francisco-based group because the French company promised a four-cents-on-the-dollar higher payout to ELIC's policyholders. The gist of the deal was that Altus Finance, an investment house in

which Crédit Lyonnais was the majority owner, bought ELIC's junk bond portfolio for \$3.25 billion. A French insurance consortium, Mutuelle Assurance Artisan de France (MAAF), invested \$300 million in ELIC and assumed management of the company. A few other ELIC assets were sold. Garamendi touted the new insurance company, called Aurora National Life, as "one of the best-capitalized and safest insurance companies in America."

Less than four years later, it seemed that buying ELIC's junk bond portfolio had been one of Crédit Lyonnais' few wise moves. After Altus Finance posted substantial losses in 1993, the French government provided a \$4.4 billion bail-out of the state-owned bank. This was not sufficient to reverse a trend of losses caused by reckless investments. Beneficiaries of Crédit Lyonnais' generosity included Italian investor Giancarlo Piretti, whose default on loans to buy Metro Goldwyn Mayer studios left the bank with a \$2.5 billion investment in Hollywood, and a two-year deadline to divest it. The bailout ultimately reached \$20 billion.

In 1999, an anonymous whistleblower forwarded to San Francisco attorney Gary Fontana documents showing that the rescue of ELIC had involved illegal "parking" agreements that allowed Crédit Lyonnais to profit at the expense of policyholders. The trail was complicated. Under the Glass-Steagall Act, a foreign bank could not own an insurance company. Although it was known in 1991 that Crédit Lyonnais financed MAAF's acquisition of ELIC, the bank had signed agreements that it would neither own nor run Aurora National Life. However, MAAF had agreed to act as a front for Altus Finance, the Crédit Lyonnais subsidiary that bought the junk bond portfolio. By separating the two deals, Altus not only circumvented the law but also was able to keep hundreds of millions of dollars in profits from the rebounding junk bond portfolio, rather than sharing the bounty with Aurora policyholders.

Near the end of 1992, maturing bonds meant that Crédit Lyonnais would own a controlling share in several U.S. companies. Forced by law to own no more than a 25 percent stake in any U.S. company, Crédit Lyonnais sold the ELIC junk bond portfolio to Artemis, a company it had formed with one of its largest debtors, multimillionaire François Pinault. Crédit Lyonnais owned 40 percent of Artemis and had lent the company \$2 million so that it could buy the portfolio. In essence, Crédit

Lyonnais was funding its sales to itself. Artemis also received all of Crédit Lyonnais' parked shares in Aurora and, when the parking agreements expired, bought the insurance company.

In October 2003, the French government rejected a tentative settlement with U.S. prosecutors for \$585 million. Prosecutors hinted at criminal charges against former Crédit Lyonnais chief executive Jean Peyrelevade and demanded extradition of four senior executives from Crédit Lyonnais and Artemis. While French president Jacques Chirac urged a diplomatic solution, Crédit Agricole, the new owner of Crédit Lyonnais, called for a settlement as preferable to a possibly more public grand jury hearing.

Since Crédit Lyonnais had been privatized and Glass-Steagall repealed, the *Financial Times* mused that the rejected settlement would have meant "French taxpayers' money is being used to pay a fine to the U.S. government for a deal done by a bank, no longer state-owned, 12 years after it allegedly broke a law that no longer exists." The situation remained unresolved in early 2004, as does a class action suit by ELIC policyholders.

#### SEE ALSO

Drexel Burnham Lambert; stock fraud; securities fraud; globalization.

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## Cressey, Donald (1919–1987)

DONALD CRESSEY is perhaps known most for his seminal work on organized crime, *Theft of the Nation: Structure and Operation of Organized Crime in America* (1969), based on his consultancy to the

President's Commission on Law Enforcement and Administration of Justice during 1966–67. His best-known work in white-collar crime was *Other People's Money: A Study in the Social Psychology of Embezzlement* (1953), which, as a dissertation under Edwin Sutherland at Indiana University, tested Sutherland's hypothesis that differential association was a viable explanation for white-collar crime.

Cressey's embezzlement study was based on 133 federally convicted "financial trust violators," finding that they could not be called "white-collar criminals" according to Sutherland's definitional criterion of respectability, and that differential association was not a meaningful explanation of embezzlers' involvement in crime. Embezzlers did not learn from significant others definitions favorable to embezzlement (although they did learn such definitions from co-workers), nor did embezzlers learn the specific techniques for committing the crime, which is another postulate of differential association.

Instead, when faced with financial problems, embezzlers needed to self-portray their embezzlement as nonharmful, now known as neutralization, particularly by some variation of the following statement: "I am only borrowing the money" (even though I don't know how or when it will be repaid). Cressey used analytic induction in *Other People's Money*, which involves deriving a commonly occurring precursor in all cases he studied (neutralizing the wrongfulness of embezzlement when faced with financial problems). Cressey's use of analytic induction has been seen as the study's major methodological flaw, because there may have been a tendency to force interpretation of facts to fit the common observation. Other researchers have since found that a financial problem is not a necessary impetus to embezzlement, nor is the process of neutralization.

Cressey's most notable contribution to the study of corporate crime is his insistence that the term anthropomorphizes because it attributes criminality to organizations rather than to individuals who commit crime on the organization's behalf. This reductionist position is a harsh critique against criminologists who assert that organizations commit crime independent of their employees. In particular, it was a critique of Sutherland's monograph *White-Collar Crime* (1949).

Although Sutherland defined white-collar crime in terms of illegal actions committed by respectable persons in the course of their occupation,

he actually studied the crime rates of corporations, not live persons.

## THE TEXTBOOK

After Sutherland's death in 1950, Cressey continued his mentor's original text, *Principles of Criminology*, which popularized differential association to young scholars in the field. The text spanned a total of 11 editions and almost 70 years (1924–92), an tremendous longevity for a social science textbook (David Luckinbill co-authored the last edition with Sutherland and Cressey). Cressey also co-authored several editions of another popular textbook (with James William Coleman), *Social Problems*. In 1982, he resurrected Donald Clemmer's classic 1939 work, *The Prison Community*, and wrote *Justice by Consent* (with Arthur Rosett, 1976) on plea bargaining, and *Criminal Organization: Its Elementary Forms* (1972).

The Donald Cressey Award is given by the National Council on Crime and Delinquency for outstanding academic contributions to criminology which promote programs and policies that are fair, humane, effective, and economically sound. The Cressey Award is given by the Association of Certified Fraud Examiners for lifetime achievement in the detection and deterrence of fraud.

## SEE ALSO

Sutherland, Edwin H.; differential association; self-control theory; consequences of white-collar crime.

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## crime seriousness

**STUDIES OF CRIME** seriousness have existed since at least 1964. Those studies generally found that respondents perceive crimes of violence to be more severe than property crimes. Also, most of those surveys have found that there is consensus between different populations on ratings of crime seriousness. Most of these studies have looked at citizens' perceptions of severity of crimes, without a clear definition of what is meant by crime seriousness or severity. Generally, the only concept common to all definitions of crime seriousness has been the idea of perceptions of crimes. Furthermore, many of these studies place a greater emphasis on traditional core offenses, such as murder, robbery, and assault, than on white-collar offenses, and crimes committed by corporations.

Those studies that have compared white-collar and corporate offenses with traditional crimes and, so called victimless crimes, have found mixed results. Some studies have found that respondents assume that all crimes are, on average, of similar seriousness. Other studies, such as one of prosecuting attorneys, have found that white-collar crimes are not perceived to be nearly as serious as traditional street crimes. This lack of seriousness associated with white-collar and corporate offenses may be the result of a couple of related reasons. Until recently, white-collar crimes were rarely the fodder of news reports, in favor of more traditional street crime, particularly violent crimes. The second reason for this may be that many people have not considered the severe consequences of white-collar and corporate crimes.

If citizens were to consider the cost or consequences of white-collar crimes, their perceptions of the seriousness of such crimes might be much higher. This suggested outcome is demonstrated in a 2001 study by Sean Rosenmerkel, in which he surveyed 268 college students on their perceptions of the seriousness of the traditional street crimes versus white-collar crimes. He found that traditional violent crimes were rated as more serious than white-collar crimes. White-collar crimes were perceived as being more severe than traditional property crimes. The same trend proved true for respondents' perceptions of the wrongfulness and harmfulness of the different types of crimes. Given media attention to high profile white-collar crimes it may not be surprising that the respondents per-

ceived white-collar crimes to be more serious, harmful, and wrong than property crimes.

James F. Short, Jr. and Laura Schrager, have noted that there are three costs or consequences of white-collar crime. The first consequence is the financial cost of white-collar crime. In 1987, the FBI estimated the annual cost of white-collar crimes to be as high as \$200 billion dollars. Since the media has begun to report on large white-collar crimes, it appears that the FBI's previous estimate may at best represent a small part of the financial costs of white-collar crimes.

The second consequence of white-collar crime is the physical or human costs. The FBI *Uniform Crime Report* shows that there were 16,204 murders in the United States in 2002. Deaths from white-collar crimes are probably higher than that if one takes into account such things as unsafe products, tainted foods, unnecessary surgeries, and work-related deaths.

The third consequence is the social cost of white-collar crime. In American society, citizens look to rich and powerful persons for role models, as well as to corporations for moral support.

#### SEE ALSO

consequences of white-collar crime; Enron Corporation; WorldCom.

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## critical theory

CRITICAL THEORY GENERALLY refers to the social theory with Marxist roots, that questions tradition and the status quo, explores and analyzes the origins of social inequality in capitalist societies and advocate radical social change. In criminology, it is an approach to the study of crime, which locates the

principal sources of crime in the structure of class inequality in society.

Drawing particularly on the work of Karl Marx and his collaborator Friedrich Engels, a primary tenet of critical theory of crime is that capitalism and economic inequality produce crimes. To explain white-collar and corporate crime, critical theorists argue that the problem is not that the individual persons who own and manage business organizations are immoral. Critical theory has adopted a structural explanation instead that focuses on the nature of society itself. A capitalist society in particular has been viewed as a fundamental source of inspiration for such crimes.

The capitalist system rests upon the systematic exploitation of the lower class and therefore encourages a level of impersonality and irresponsibility that is conducive to white-collar and corporate crime. One of the most dangerous conditions creating the propensity to white-collar and corporate crime is the need for capitalism to dehumanize people, transform many objects of human environment into commodities, and create false needs.

Critical theory suggests that crime is a rational or inevitable response to an economic system that generates competitiveness, greed, and egoism. Corporations specifically, with their emphasis on maximizing profit and minimizing cost to survive, will routinely violate antitrust laws, labor laws, worker safety laws, consumer protection laws, tax laws, currency regulations, environmental protection laws, trade laws, and conflict-of-interest laws.

Critical theory says honest capitalists cannot survive long in a real competitive system. The capitalist corporation houses and protects white-collar and corporate criminals. Doctors, lawyers, accountants, professors, and other decent professionals will violate the trust of the office or job they hold to satisfy their drive for private accumulation. One cannot explain white-collar and corporate crime in the terms of biological determination, differential association, or control theory. It is the nature and dynamics of capitalism that drives the rich and the powerful to commit crime on an everyday basis.

## THE INSTRUMENTALIST PERSPECTIVE

Critical theory has also examined the process of legislation and enforcement against crime. The central idea of critical theory is that the law is political and it is not neutral or value-free. The law reflects



the structure of the power relationships of the society. Critical theorists are, however, divided by the extent to which the state protects the interests of capital. An instrumentalist critical perspective on law and regulation advances the view that, in a capitalist society, law is the direct instrument of capital, which reflects the rich and powerful class's control over the state and is intended to favor the interests of that class. Capital and the state elite are in fact one and the same. The wealthy and the powerful manipulate the definition of what is widely considered criminal in order to maintain their domination in society. For example, occupational safety laws and environmental protection laws are absent or weakly enforced, to promote the interests of business.

According to the instrumentalist critical view, the law in a capitalist society simply helps promote white-collar and corporate crimes. The modern corporation is a device by which those who benefit from its illegal activities may escape justice. The most successful corporations, those that accumulate the most are those that are the most criminal and the most adept at growing above the law. Such crimes, therefore, can be obliterated only by abolishing the private ownership of property and transforming the capitalist into a socialist society, where people live in egalitarian and cooperative relationships with each other. In such a society there is simply no need for criminal law.

The instrumentalist perspective, however, has been under attack for its oversimplified explanation of the relationship between the state and capital. It overstates the degree of homogeneity in the capitalist class and ignores the diversity of interests among the class.

## THE STRUCTURALIST PERSPECTIVE

An alternative structuralist critical perspective argues that the state is structurally dependent on capital, but relatively independent from capital under certain circumstances. According to this perspective, in a capitalist society, law is used by the state to maintain the long-term interests of the capitalist system and control members of any class that poses a threat to its existence, rather than to advance the specific, immediate interests of capitalist elites and organizations. In this view, not all white-collar crimes would be punished. Only those that constitute a threat to the existing political order are pun-

ished by law, because doing so helps sustain the system and legitimates the state in the eyes of its citizens.

According to the structuralist view, the state is limited by capital in that it is responsible to secure the political, social, and economic conditions under which the capitalist class can profitably operate. Law ultimately reinforces capitalist values and serves capitalist needs of exploitation. Business has generally had disproportionate influence over the law-making process and enforcement.

Much of the critical theoretical work today is less concerned with the causes of crime than with how criminality is socially defined along lines of class, gender, and ethnicity. Crime and law are seen as a reflection of inequality in a capitalist society. Since the early 1980s, a number of new perspectives have emerged under the umbrella of critical theory. These perspectives include left realism, peacemaking criminology, feminist perspectives, and post-modernist criminology. Attempts to apply these perspectives to the analysis of white-collar and corporate crime, however, are at a very early stage.

## SEE ALSO

differential association; capitalism; free enterprise system; Sutherland, Edwin H.

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## Cuba

LITTLE IS KNOWN about the nature and scope of white-collar crime in Cuba due to the closed nature of the communist society. However, there is considerable information on the role of American organ-

ized crime in Cuba and its association with white-collar crime in the years preceding the Cuban Revolution.

Ties between the American underworld and pre-communist Cuba began during Prohibition (1920–33), when Cuban sugar and rum were exported by mob-controlled syndicates to the United States. Cuba was also used as an international meeting place for Mafia-linked criminals. In December 1946, the heads of the American crime families met in Havana to settle their disputes and to plan for the future. The meeting was called by two of America's most influential mobsters: Meyer Lansky and Charles Luciano, who had just been exiled to Italy by the U.S. government. The purpose of the meeting was to reassert Luciano's dominance over American criminal operations.

Legend has it that it was at this meeting that the heads of New York's five Mafia families also agreed to increase their involvement in heroin trafficking. After the meeting, Luciano attempted to stay in Cuba, but the Cuban government forced him to return to Italy at the urging of the U.S. government.

#### ORGANIZED CRIME'S HEYDAY

The most active period for American organized crime in Cuba was the 1950s. Lanksy, the entrepreneurial mastermind behind the American Mafia in the first half of the century, nurtured a strong relationship with Cuba's corrupt dictator Fulgencio Batista and was rewarded with the opportunity to open and operate hotel casinos in Havana. Lansky had taken over the gambling tables of Havana's Montmartre Club in the mid 1930s, and soon after Batista assumed power in 1952, he invited Lansky to expand his operations and even serve as a government adviser to help clean-up the many crooked games of chance and fraud operating in Cuban casinos. This invitation spurred a tidal wave of American mob investment in and control over legalized gaming in Cuba.

In the face of increased law enforcement scrutiny in America and buoyed by the unfettered support extended by Batista, Lansky and Luciano, along with Frank Costello and Santo Trafficante, Jr., viewed the Caribbean island as an ideal sanctuary within which they could expand their gambling empires. In his 1976 self-published book, *The Mafia Conspiracy*, John Scarne estimated that during the 1950s, the American Mafia indirectly controlled no

less than 19 casinos in Cuba. In return, Batista and his associates were compensated with millions of dollars in bribes as well as a percentage of the revenues of the mob-run hotel-casinos.

In effect, the Mafia's major white-collar criminality was not gambling activities, but rather the bribing and corruption of the Cuban Batista government. A crime that not only led to the end of Batista, but also to the rise of the anti-corruption Cuban Revolution.

Soon after the Cuban Revolution, communist leader Fidel Castro made it clear that American investors were no longer welcome in Cuba; he shut down most of the mob-operated casinos, proclaiming that the gangsters behind them were the ultimate, crooked metaphor of the American capitalist system. In 1959, Castro even briefly jailed Florida mob boss Trafficante, who had financial interests in Havana casinos since 1946.

Trafficante was later, allegedly, involved in a CIA plot to assassinate Castro, and according to his testimony before a Congressional committee in 1975, he recruited several other underworld figures for this purpose in the early 1960s. However, Sam Giancana, the long-time head of the Chicago Mafia, as well as some in the U.S. law enforcement community, believed that Trafficante had never intended to assassinate Castro, and instead began cooperating with the Cuban leader to kill U.S. President John F. Kennedy. Trafficante was called before a House of Representatives committee in 1978 to answer questions about a sworn statement by Jose Aleman that Trafficante told him, "Kennedy's gonna get hit."

One of the many conspiracy theories used to explain Kennedy's assassination in 1963 was that it was a coordinated effort between Castro and the American Mafia, stemming from their mutual hatred of Kennedy and his anti-organized crime crusading brother Robert, who was the attorney general in the Kennedy administration.

#### THE BAY OF PIGS

When Castro expelled American gangsters in the late 1950s and early 1960s, many of their Cuban associates fled to the United States, including those involved in Cuba's cocaine trade. They eventually settled in New York, New Jersey, and greater Miami which soon become central locations for the importation and distribution of cocaine from Colombia during the 1960s and 1970s.

Many of the Cubans who fled with the Batista loyalists were organized by the CIA in an effort to dislodge Castro by invading Cuba with a small force at the Bay of Pigs, a secluded inlet on the Cuban coast. Due to lack of military air support and proper planning, the invasion force was quickly repelled by Castro's troops, resulting in an unmitigated political disaster for Kennedy.

After the Bay of Pigs debacle in 1961, members of the CIA-organized Cuban exile army were expected to disband and go into lawful businesses. However, as author Donald Goddard points out, "They had no lawful business." At first, the Cuban exiles imported only enough cocaine to satisfy members of their own expatriate community in the United States. However, by the mid-1960s, the market had expanded far beyond the Cuban community, which resulted in a dramatic increase in the quantities imported into the United States.

Until the early 1970s, the importation of cocaine (as well as marijuana and Quaaludes) into America was largely a Cuban operation, but by the late 1970, the Cubans remaining in the cocaine business had become subordinate to Colombians. While the location of Cuba between the United States and the cocaine-producing countries of South America continues to make Cuba a logical trans-shipment point for traffickers, according to an international narcotics control strategy report prepared by the U.S. State Department, Cuba is "not a major transit country for drugs coming to the United States." However, in 1989, Cuban General Arnaldo Ochoa Sanchez and several other officers in the country's Ministry of the Interior were arrested on charges of drug-trafficking. The so-called LaGuardia Group headed by Ochoa began trafficking in 1987. A key question was whether this activity was authorized at the highest levels of the Cuban government. Trial evidence and press reports indicate that higher authorities in Cuba did not authorize drug-trafficking; rather, the LaGuardia Group's cocaine trafficking activities was based on ambition and a misguided desire to obtain as much hard currency for Cuba as possible.

#### SEE ALSO

organized crime; corruption; drug trafficking; Kennedy, John F.

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## Cullen, Francis T. (1951–)

FRANCIS CULLEN, distinguished research professor in the department of criminal justice at the University of Cincinnati, is a prolific and widely read scholar. As of 2003, he had published over 170 works covering crime and deviance theory, corrections, white-collar crime, public opinion, and sexual victimization. He is the recipient of the Outstanding Scholarship Award from the Crime and Delinquency Division of the Society for the Study of Social Problems and has served as president of the Academy of Criminal Justice Sciences and the American Society of Criminology.

Having experienced the public and political unrest of the 1960s, social context and consequences have played a major role in shaping Cullen's career. Cullen attended an inner-city Boston, Massachusetts, high school during a time when racial equality dominated public and political agendas. He began his studies in urban education at Columbia University in 1974. His deviance and social-structure course with Richard Cloward, who later became his mentor, and the influence of Robert Merton inspired much of his subsequent work. He received his Ph.D. in 1979 in sociology and education from Columbia University. His dissertation, *Rethinking Crime and Deviance Theory: The Emergence of a Structuring Tradition*, was published in 1984.

Cullen's contributions to the study of white-collar crime and criminology emphasize the role of social context and public policy. His case study (with Willaim Maakestad and Gary Cavender) of

the corporate misdeeds in the Ford Pinto case focused attention on the process and difficulties of prosecuting white-collar crime under criminal law.

### FLAMING PINTOS

The Pinto case erupted in 1978 when the automobile was to found to engulf in flames after being rear-ended. In one case, two passengers trapped in the car died. The fires were caused by the location of the gas tank and Ford's decision not to fix the defect, based on a cost-benefit analysis, came from an insider whistleblower's complaint. Ford Motor Company was brought within the realm of criminal law when the state of Indiana charged the company with reckless homicide, though the jury voted for an acquittal.

The case presented by Cullen further fueled public and academic interests in corporate unlawfulness, and the usefulness of the case-study method for explaining and understanding white-collar crime. His 1998 book (with Michael Benson) represented a major contribution to the means and methods of prosecuting white-collar criminals. *Combating Corporate Crime* explores the role of the judicial system and the efforts by local prosecutors to control fraud and ensure accountability for corporate misconduct.

### SEE ALSO

Ford Pinto; Ford Motor Company; prosecution; corporate criminal liability; differential association theory.

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## currency fraud

CURRENCY fraud is the production or manufacturing of paper money and coins, without the right

to do so, replicating currency already circulating within the economy with the purpose of deceiving and defrauding, or genuine paper currency which has been altered to increase its face value. One of the first episodes in American history involving the production of fraudulent paper currency occurred during the American Revolution. In 1775, the Continental Congress issued \$242 million in Continental currency to finance the Revolutionary War. The British, however, were able to replicate this currency and began distributing it throughout the American colonies.

As a result, the currency issued by the Continental Congress rapidly depreciated and was soon deemed worthless giving rise to the phrase "not worth a Continental." Subsequently, the Founding Fathers were compelled to declare the production of fraudulent currency a crime. Therefore, they bestowed upon Congress the power to punish such an act by means of the Counterfeiting Clause contained within Article 1, Section 8, of the U.S. Constitution. According to the Counterfeiting Clause, "Congress shall have power ... to provide for the punishment of counterfeiting the securities and current coin of the United States."

The production and circulation of fraudulent currency became a severe problem in the United States during the Civil War. At this time, there were approximately 1,600 state-chartered and unregulated banks each of which designed, issued, and printed their own banknotes. These notes were easily replicated and over 30,000 different varieties were in circulation, which led to massive confusion and bank failures throughout the country. To address this problem, Congress standardized American banknotes in 1863 by issuing a single national currency. These national bank notes, commonly referred to as greenbacks, contained complex designs and were printed on a high-quality cotton and linen paper authorized by the U.S. government.

This newly established national currency curtailed the fraudulent replication of paper notes only briefly and shortly thereafter, fraudulent currency flooded the economy once again. Consequently on July 5, 1865, the Secret Service was established as part of the Department of the Treasury, with the sole mission of protecting the integrity of U.S. currency. Within 10 years, the production of fraudulent currency was curtailed.

In 1913, Congress passed the Federal Reserve Act establishing the nation's Federal Reserve Sys-

tem, which authorized Federal Reserve banks to issue Federal Reserve banknotes. The following year, the banks began to issue the Federal Reserve banknote, and since its inception, the design of U.S. States currency has remained largely unchanged. The Bureau of Printing and Engraving, a branch of the Department of the Treasury responsible for production of U.S. security documents, has relied entirely on special inks, paper, and a printing process once thought to make the fraudulent production of currency extremely difficult, if not impossible, through a process called intaglio printing. Intaglio printing utilizes a very costly and powerful press that forces ink to penetrate the distinctive, high-quality paper that consists of 75 percent cotton and 25 percent linen, embedded with red and blue fibers, which has been manufactured exclusively by Crane Paper in Massachusetts since 1879.

Intaglio printing uses an estimated 20 tons of pressure per square inch, stretching the paper's cotton and linen fibers, and causing the green and black ink to penetrate below the paper's surface. The end result is a paper note containing fine lines and intricate detail, which has made it very difficult to duplicate.

Subsequently, those engaging in the production of fraudulent paper notes have been forced to use a more common cotton and linen paper and offset printing presses, resulting in the loss of intricate detail as well as a poor quality of print. Once printed, the fraudulent paper notes are placed in a washing machine in order to give the look, feel, and appearance of a genuine paper note that has been in circulation for quite sometime. In some instances, bills of lower denominations have been bleached removing the ink from the paper and reprinted as a bill of higher value. A simpler and more common form of currency fraud is the raised note. The raised note is genuine paper currency, which has been altered in an attempt to increase its face value. This process involves gluing numerals from notes of higher denominations to the corners of notes of lower denominations, such as using a \$1 bill to make \$100 banknote.

The 20th century, however, has ushered in remarkable advances in computer and photographic technology making it possible for people, without any sophisticated training to easily replicate and manufacture fraudulent currency. Those engaging in the production of fraudulent currency have now added digital scanners, advanced full-color copiers,

ink jet printers, laser printers, and advanced graphics software to their arsenal. These technologies have allowed those engaging in the production of fraudulent currency to produce high-quality fraudulent bank notes.

## CURRENCY REDESIGN

As a result, in March 1996, the Department of the Treasury released into circulation newly designed U.S. currency for the first time in over 70 years containing the most advanced security features available. The most obvious change in design is the much larger, off-centered portrait, incorporating more detail making it easier to detect fraudulent bills. Moving the portrait off-center allowed for the inclusion of a watermark depicting the same person shown in the portrait. This feature prevents someone from bleaching the ink off bills of lower denominations and reprinting them as a bill of higher value.

Furthermore, the numerals on the lower, right-hand corner of the bill have been printed in optically variable ink, which changes in color from green to black when viewed from different angles. Moreover, a nylon security thread imprinted with the value of the note is now located in a different position on each denomination thereby making it virtually impossible to bleach bills of lower denominations with the hopes of producing a bill of higher face value.

Others around the world, however, have refined the production of fraudulent U.S. currency into an art. As a result, the Secret Service's mission has become global. In 2002 for example, the Secret Service seized \$86 billion in Colombia. The Secret Service and Colombian law enforcement agents discovered a metal plate in the middle of a banana plantation covering a hole that led to an eight-foot tunnel, which in turn led to a narrow passageway. Once inside, the agents discovered a 12-by-15-foot room that housed a state-of-the-art printing press, negatives, and ink. An investigation revealed that the printing press was used to manufacture approximately \$20 million in fraudulent U.S. currency that had entered into world circulation over a 10-year period.

According to the Secret Service, those involved in the production of fraudulent currency in Colombia have used advanced techniques including burning images of genuine currency onto metal printing

plates. Paper, once used for the production of Venezuelan bonds and closely resembling the paper used by the U.S. Bureau of Printing and Engraving, is then passed through a printing press eight to 10 times, producing a fraudulent paper note that feels and looks like genuine U.S. currency. The difference, however, is that fraudulent currency created and manufactured in Colombia has the watermark and security strip printed on, rather than imbedded within the paper itself.

The Department of the Treasury has made it much more difficult to manufacture fraudulent currency by employing the most advanced security features available. Even if technology could replicate each security feature, there is no single counterfeiting machine that could replicate all features simultaneously. Even those considered expert in the production of fraudulent currency and possessing state-of-the-art technology, such as the Colombian operations, are unable to produce an exact replica of a U.S. Federal Reserve banknote.

#### SEE ALSO

forgery; scams; counterfeiting; bank fraud.

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## cyberstalking

THE TERM *cyberstalking* is generally considered to refer to the act of harassing or threatening an individual through the use of the internet and elec-

tronic or computer communications. The most commonly employed communication method used in the commission of this act is e-mail. However, there is a growing belief that instant messaging is seeing an increased use in cyber stalking in the early 2000s. For a victim to prove cyberstalking, she must be capable of proving that the messages were threatening and inflicted fear upon her life.

If the message is such that a reasonably prudent person would not believe that the sender was, in fact, threatening the victim, then there is no case for alleging cyberstalking. Distinguishing between the presence of a threatening message and one that is designed to merely aggravate a recipient is not always an easy task.

This statement, however, should not be construed as indicating that multiple messages are required. Contrary to popular belief, it is possible for the first, or even only, electronic message to be considered threatening, and thereby result in the individual committing an act of cyberstalking. Cyberstalking is considered a dangerous crime because many times the stalker will transcend the virtual world and begin stalking a victim in the physical world.

In much the same manner as traditional stalkers, it is believed that many cyberstalkers select their victims by first becoming acquainted with the individual in a social setting. The major distinction between a physical-realm stalker and the stalker in cyberspace is that many times the victims and the stalkers can easily come from different locations around the world.

The very nature of cyberspace, with its anonymity and worldwide access, lends itself to the development of international victims, as well as victims of opportunity, or victims who are not acquainted with the stalker. At any given time on the internet, there are hundreds of thousands of topic-centered chat rooms in operation that allow individuals, who have never met face-to-face, to converse as if they are long-lost friends. The level of anonymity in these chat rooms has been shown to lead some individuals to make statements and commit acts they would never have considered if the discussions had taken place in the real world.

The exact extent of cyberstalking is currently unknown, as data concerning the breadth of the problem is lacking. Few victims may understand that electronic harassment is illegal, and even worse many law enforcement agencies have yet to fully

begin investigating reports of this crime. In addition, statutes criminalizing cyberstalking have only recently been put into place, with California being one of the first states to criminalize the behavior, and several states yet to criminalize electronic harassment and stalking.

Further, federal statutes have been criticized for their failure to account for situations in which cyberstalkers post misleading information about a victim, and then use unknowing individuals to assist in the harassment of a victim. There is hope for future research concerning this issue, as more law enforcement agencies have begun to seriously investigate the crime and an improvement in the current

records are sure to create valuable research opportunities.

#### SEE ALSO

sexual harassment; Computer Fraud and Abuse Act.

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# D

## **daisy chains**

A DAISY CHAIN IS the terminology used to describe a series of businesses that are connected together for purposes of a business transaction. Normally, the transactions involved are either criminal or fraudulent activities, and the businesses are “chained” together in an attempt to make investigating the criminal activities of the companies difficult.

Investigators devote endless time and energy to locating a company at the end of a daisy chain, only to discover that by the time the end of the chain is located, the corporation that has chained the companies together may have removed the final company in an attempt to hide the activities.

The use of daisy chains is perhaps best exemplified in the transactions of oil and fuel companies. The oil industry is controlled by legislation that mandates the pricing of oil. Therefore, no one company can obtain the same profit that could arise in a free market, because no one company is allowed to sell oil at the maximum price that the general public will pay.

Daisy chains attempt to increase profits by aligning companies that will sell the oil to each other. The first company will obtain the oil at the average market price of the commodity. Company number one will then sell the oil to company num-

ber two in a manner that maximizes its allowable profits. Company number two will then operate in the same manner, selling the oil to a third company and maximizing its profits in the process.

This process continues throughout the daisy chain until such time as each company involved has maximized its profits. Once everyone has profited, the oil is then sold to a legitimate company that is not a part of the daisy chain. This company is then forced to pay a significantly higher price for a product. Thus, each of the companies in the daisy chain maximizes its profits at the cost of the end purchaser.

The use of a daisy chain in fuel-fraud schemes is often linked to the activities of organized crime groups such as the Russian Mafia. These entities employ daisy chains to falsify state and federal tax forms involving the sale of fuel. Several companies are established, as is a “burn company.” The burn company is nothing more than a company that exists only on paper. When investigators begin to close in on the criminal activity, the burn company is destroyed.

Because the company exists only on paper, there is no record of assets and the trail dissolves. Through the use of these falsified companies, organized crime groups can make as much as 50 cents per gallon, costs that are saved from not paying the federal and state taxes. With these savings it is pos-



sible for operators of the daisy chain to sell fuel at a lower price than their competitors. By undercutting the prices of legitimate fuel retailers, the organized crime group forces their competitors out of business. The former competitors can be bought out and the fuel prices can be increased.

Daisy chains have also been linked to the activities of stock traders and investment firms, but their use is primarily linked to fraudulent activities that involve the sale of commodities like that of fuel and oil. The very nature of daisy chain schemes make the investigation and prosecution of operators difficult, and leads to a need for better training and awareness among those in the criminal justice field who encounter such operations, awareness that is sure to be increasing every passing day.

#### SEE ALSO

accounting fraud; organized crime; stock fraud.

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## Daiwa Bank

THE DAIWA BANK SCANDAL received significant media coverage in both the United States and Japan. On September 25, 1995, Daiwa Bank, one of Japan's largest banks with offices worldwide, admitted that Toshihide Iguchi, the head of bond trading in the bank's New York City branch had misappropriated \$1.1 billion of customer securities over a period of 10 years to conceal trading losses. On October 9, 1995, Daiwa officials made the additional disclosure that it had concealed more losses in excess of \$97 million dollars that had been shifted to a corporate shell in the Cayman Islands between 1984 and 1987.

On November 2, 1995, the U.S. Federal Reserve announced the closing of the bank's American operations. The bank was required to provide federal regulators with status reports every 5 days over the 90-day period within which it was required to termi-

nate and withdraw all operations from the United States for three years.

The severity of the penalties originally faced by Daiwa Bank (expulsion and a 24-count federal indictment carrying \$1.5 to \$4.4 billion in fines if convicted, rather than fines alone) was attributed to the fact that the bank was not more forthcoming with disclosure of its losses. The bank did not inform the powerful Japanese Ministry of Finance until August 8, 1995, and the ministry did not, in turn, inform U.S. regulators until September 15, 1995. By these actions, both the bank and the ministry showed a disregard for U.S. law, resulting in a breach of trust between governments. Fortunately, the bank had enough money to cover the losses.

The Daiwa Bank fiasco was not a problem particular to the Japanese institutional and cultural context. Rather, Daiwa Bank underscored how lenient internal controls and regulatory scrutiny had created conditions that contributed to similar scandals threatening the viability of top financial institutions around the world.

In banking circles, it is widely accepted that employees have incentives to breach management controls and compliance procedures. Banks need to respond by adopting internal controls and submitting to regulatory oversight in an effort to locate violators before the firm is exposed to billions of dollars in risk.

Prompt and immediate disclosure and cooperation with regulators has been recommended as the most immediate remedy to the ongoing problem of employees finding loopholes in the management controls and compliance procedures. Doing so not only protects a firm from the accumulation of higher losses in the long-term, but a prompt response enables a firm to establish a credible track record. U.S.-based traders such as Prudential Securities and Salomon Brothers, have, upon report of major infractions, been allowed to continue business with payment of substantial fines.

Although these firms were found guilty of infractions varying from failure to inform investors of the extent of risk associated with their purchased investments to concealment of losses, immediate disclosure allowed them to preserve their reputations.

#### SEE ALSO

bank fraud; accounting fraud; offshore entities; Japan; offshore banking.

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## Dalkon Shield

THE DALKON SHIELD was a defective intrauterine birth control device manufactured and sold by the A. H. Robins Co. of Richmond, Virginia, from January 1971 through June 1974. It cost \$3, but caused numerous injuries, including miscarriages, loss of female organs, and infertility. Like other intrauterine devices, the Dalkon Shield was designed to be inserted inside the uterus, where it usually prevented pregnancy by making it difficult for a fertilized egg to attach itself to the wall of the womb. Robins sold 4.5 million Dalkon Shields around the world, including 2.8 million in the United States.

The Dalkon Shield appeared on the market just after the sexual revolution of the 1960s. Women, whether married or not, were no longer bound by compulsory images of motherhood, yet there was no 100-percent effective birth control method yet developed. The "pill" required a woman to remember to take it on a daily basis. There were also the various health concerns and adverse effects of the pill to contend with. The Dalkon Shield was touted as being a safer and more effective method of birth control than the pill.

When the Dalkon Shield was marketed, there were no required tests by the Food and Drug Administration (FDA) for the manufacturing of medical devices to prove that they were safe and/or effective. Only one small study was performed on the Dalkon Shield, after it was sold worldwide. The testing of the Shield is a clear-cut case of conflict of interest. The inventor of the Shield was the person who tested it. Moreover, if that was not bad enough, he was heavily invested in the product. He was entitled to a percentage of the profits from its sale. Before A. H. Robins purchased the rights to the Shield, executives were informed that the tests

may not have been adequate, but they ignored the warnings.

The device was defective. It had a major design flaw. The device had a nylon tail that hung through the opening of the uterus for doctors to check to make sure the device was still in proper place. The tail, however, allowed bacteria to travel up the device's wick and into the womb causing infection, which sometimes resulted in sterility. The Shield was not a very effective birth control device, yet A. H. Robins promoted it as the most effective form of birth control on the market. They advertised it as having a 1.1 percent failure rate. This was false because approximately 5 percent of the women using the Shield actually became pregnant.

The women who became pregnant suffered miscarriages and other reproductive system problems, like PID (pelvic inflammatory disease). Twenty women died from complications associated with the Dalkon Shield. The death rate may be higher, especially in Third World countries where statistics are not collected. The women who wore the device were not the only victims. Hundreds of children were born with injuries inflicted by the Dalkon Shield because it was not removed during pregnancy. Children were born inflicted with blindness, cerebral palsy, and mental retardation.

Despite the fact that A. H. Robins had early indications of these problems, they neither voluntarily warned women nor withdrew the Dalkon Shield from the market because the product was highly profitable. They did not even order more testing of the product. In fact, the company launched one of the most aggressive promotional campaigns in its history.

Even with knowledge that the Dalkon Shield was prone to pelvic infections, A. H. Robins promoted the Shield widely to doctors and general practitioners. They also advertised that the Dalkon Shield could be safely left inside the women for up to five years, even though medical evidence stated that the longer the Shield was in place the greater the risk of infection and complications.

As more and more reports of infections, pregnancies, and miscarriages were reported, the FDA investigated the Dalkon Shield. After much stonewalling by the company, the FDA halted distribution of the product in 1974. To completely protect Shield users, health experts said a complete recall should have been ordered. However, the FDA ordered a voluntary suspension of sales instead.

Since A. H. Robins was not ordered to recall the product, they did nothing to warn the thousands of women who were already users of the dangerous product. It was not until 10 years later, in 1984, that the company undertook a massive media campaign to inform the women wearing the Dalkon Shield, in the United States, to have them removed at A. H. Robins's cost. This was done only after Robins's liability insurer, Aetna, canceled their policy because they discovered that Robins had failed to disclose relevant information and, in some cases, provided false and misleading information to doctors and women.

Many of the injuries from the Dalkon Shield happened to women between 1974 when A. H. Robins stopped marketing it in North America and 1984, when the company finally wrote to physicians and sponsored a media campaign aimed at reaching women to recommend its removal. However, A. H. Robins continued to sell the Shield abroad.

#### LITIGATION AND SETTLEMENT

Lawsuits were filed not long after the Shield was on the market. During pre-trial discovery in many of the cases, documents retrieved from Robins showed that the company definitely knew about the device's proclivity to cause life-threatening pelvic infections. They were aware of this and withheld the information and, in some cases, evidence was destroyed.

Early on, the Dalkon Shield did undergo some design changes. These were never tested. The designers added copper to the mold so the device would show up easier on x-rays, and it was also thought to be an enhancement to its effectiveness. Adding copper to the device would mean that the FDA should have given pre-market approval for the device because the copper would have a medical effect. A. H. Robins did not want to have to get FDA approval. That would require more rigorous testing and the Shield might never had made it to the market. In order to avoid such testing, A. H. Robins told the FDA that the Dalkon Shield contained less copper than it actually did.

A. H. Robins officials deliberately adopted a defense strategy of dragging out any case. This was done to make it expensive and difficult for the injured women and their attorneys to file suit. If the case did go to court, A. H. Robins' attorneys, in some cases, personally attacked the women plaintiffs by insinuating that their sexual and hygiene

habits, rather than the Dalkon Shield, were responsible for their injuries. The attorneys said the number of sexual encounters and partners caused pelvic infections and this was the cause of their problems, not the Dalkon Shield.

Two top executives were found guilty of criminal contempt. Flooded with lawsuits, Robins sought bankruptcy protection from litigation in 1985. A bankruptcy filing automatically halts all litigation against a company, and the women injured by the Dalkon Shield were converted to creditors instead of plaintiffs.

There were over 300,000 Dalkon Shield claims filed in the bankruptcy court. The Dalkon Shield Claimants Trust was established in 1989. A \$2.3 billion trust was set up by American Home Products Corp., a Madison, New Jersey-based company that bought A. H. Robins. During the 1990s, the Dalkon Shield Claimants Trust paid out nearly \$3 billion to more than 200,000 women who had used the intrauterine contraceptive device, making it one of the most successful settlements for claimants of mass tort litigation.

The average claimant represented by a lawyer got about \$21,000. However, most of the women did not receive much compensation, only about \$725. The largest payment was more than \$2.2 million to the family of a severely deformed girl born after being conceived while her mother was using a Dalkon Shield.

Today, pre-market testing requirements exist for medical devices because of the Dalkon Shield catastrophe. The Food, Drug, and Cosmetic Act of 1938 placed medical devices under federal control, but they were not subjected to pre-market review until 1976. The Medical Device Amendment of 1976 was enacted in direct response to the Dalkon Shield fiasco.

#### SEE ALSO

A. H. Robins; class-action lawsuits; consumer deaths; healthcare fraud; Food and Drug Administration.

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## day fines

DAY FINES ARE ALSO commonly known as structured fines and refer to monetary fines that are calculated on the basis of a convicted individual's financial status. Originally used in Europe, day fines differ from traditional, pre-established fines in that they are calculated using a two-step mathematical formula. The first step of calculation involves the individual's offense being rated on an established scale using the gravity of the offense as a basis for consideration. The second step involves multiplying the number of units from step one by a percentage of the offender's daily income. Along with daily income, the number of dependents living with the offender is considered, as is any additional financial considerations deemed important by the court.

Sweden developed the day fine system in the 1920s, and its success led to its adoption by West Germany in the early 1970s. After day fines used in West Germany led to a 90-percent decrease in sentences of less than six months, the United States elected to attempt the use of the sanction in 1988. Richmond County, Virginia, under the guidance of the Vera Institute of Justice, successfully employed the sanction for one year and found that judges were more likely to use day fines than short jail sentences. Additionally, fine amounts increased by a significant amount and collection rates in the court system rose to 85 percent.

The use of day fines has received mixed support in the criminal justice system, with supporters arguing that the system is effective because it deters financially secure individuals from committing crimes and, at the same time, provides financial revenues for the court. The deterrence argument stems from the belief that traditional fines, which are equal regardless of social class, do not inflict sufficient harm on a wealthy defendant. Therefore, a

wealthy defendant may commit a crime because she realizes she is capable of paying the fine without losing a significant amount of income. Under the day fine system, this same individual may reconsider her desire to commit a criminal act because she fears the financial result of the act.

Day fines also prevent the already over-burdened criminal justice system from having to deal with offenders who pose less of a risk to the public. Instead of the justice system paying for a supervised release or treatment program, the offender is instead paying the court for her mistakes. The only true criticism of the system is that the method of calculation leads some to argue that offenders could hide their income for purposes of avoiding high day fines, a problem that is believed to be correctable with proper management and training in the application of day fines.

### SEE ALSO

prosecution; consent agreements, decrees, and orders; reform and regulation.

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## debt restructuring fraud

DEBT RESTRUCTURING fraud is a method whereby an individual or an officer of a corporation with outstanding debt obligations knowingly and fraudulently conceals or transfers assets belonging to the estate of the debtor, prior to a Chapter 11 bankruptcy filing, with the intent to defraud creditors and avoid legitimate debts.

Debt restructuring fraud, referred to as fraudulent transfer or concealment, is defined within the bankruptcy fraud statute, codified at 18 U.S.C. §152, and states, "A person who in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under Title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of



*The prospect of business failure can lead executives to attempt various forms of debt restructuring fraud.*

Title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation shall be fined not more than \$250,000 or imprisoned not more than five years, or both.”

Generally, 18 U.S.C. §152 requires that the fraudulent transfer and concealment of assets by the debtor occur knowingly and fraudulently. Precise definitions of “knowingly” and “fraudulently” are provided within 18 U.S.C. §152. Accordingly, the term “knowingly” means, “the defendant is aware of his or her act or failure to act and that his or her conduct is undertaken voluntarily and intentionally and not because of mistake or accident or other innocent reason.” The term “fraudulent” means, “the conduct was willful and done voluntarily and intentionally and with the intent to deceive, cheat, or defraud. An intent to defraud is accompanied, ordinarily, by a desire or purpose to bring about some gain or benefit to oneself or to cause some loss to some person.”

In order to sustain a conviction under 18 U.S.C. §152, the government must prove beyond a reasonable doubt that the defendant “knowingly and fraudulently, concealed from an officer or the creditors, in a Title 11 case, property belonging to the estate of the debtor.”

In many cases involving debt restructuring fraud, business owners blatantly transfer corporate assets prior to a bankruptcy filing for their own personal benefit. Examples of obvious fraudulent transfers include: transfer of corporate funds to pay the owner’s personal debts; transfers to third parties who in turn provide insiders with significant gains; and cash transfers directly to the owner of the corporation for no legitimate business purpose or activity.

## CHAPTER 11 TRICKS

For example, a business owner files a Chapter 11 bankruptcy because his company is facing a severe cash shortage. Just prior to filing for bankruptcy, the business owner transfers large sums of cash and other company assets to family members and other business interests in which he controls, thereby concealing and protecting his assets from sale or liquidation. Business owners have also taken more extreme measures when financial failure appears forthcoming, such as large retroactive raises, large bonuses, and redemption of company stock.

Although the majority of fraud in bankruptcy proceedings consists of the concealing or transfer of assets, there are a number of schemes designed primarily to maximize company profits prior to a bankruptcy filing, including bust-outs, bleed-outs, and parallel entities. According to the Federal Bureau of Investigation, the bust-out is one of the more common bankruptcy crimes involving the fraudulent restructuring of debts. A bust-out involves the creation of a business that is designed to fail from its very inception. Typically, an operator of a bust-out will open a business and establish a solid credit rating with large consumer goods manufacturers.

Eventually, the operator will purchase merchandise on credit. Once obtained, the merchandise is either sold for cash or transferred to business associates. A bankruptcy is then filed, leaving creditors without any recourse for collection. According to the Department of Justice, following a bust-out, “records are destroyed, fires are set, and robberies are faked in an effort to disguise what actually took place.”

A bleed-out is similar to a bust-out, except it involves depleting the assets of an existing company over a relatively long period of time. A bleed-out typically involves a stable company with very liquid

assets, such as a large pension or profit-sharing fund that is acquired through a leveraged buyout, often by a corporate raider. Once acquired, the company continues to operate until all available assets are depleted. Once all the assets of the company have been depleted, a Chapter 11 bankruptcy is filed allowing those raiding the company to complete their scheme.

Lastly, when a long-standing company experiences financial difficulties, business owners may create a second business, or a parallel entity, which mirrors the first business, prior to or immediately after a bankruptcy filing. Once a Chapter 11 bankruptcy has been filed, the business owners continue to operate their original business until they have successfully transferred all "inventory, receivables, customers, and good will" to the newly established company, explains the Department of Justice. In some instances, business owners will continue obtaining goods as their original business, and then transfer them to their parallel entity without any intent on ever repaying creditors.

The bankruptcy system was created to provide a forum in which creditors and debtors could compromise settlements in ways satisfactory to both and help provide a fresh start to those with a demonstrated financial need. The bankruptcy system, however, has been manipulated and its integrity comprised. According to the Federal Bureau of Investigation, "the wider acceptance of bankruptcy in the United States has led to a 500 percent rise in bankruptcy filings since 1973. By 1995, 250 fraudulent bankruptcies were being filed daily."

As a result in October 1995, a time when bankruptcy cases were beginning to approach one million per a year, Attorney General Janet Reno issued a memorandum stating, "The potential for fraud and abuse in a system involving such enormous amounts of money and complex financial transactions is great." As a result, the Department of Justice made the prosecution of bankruptcy cases involving fraud a top priority launching Operation Total Disclosure, which focused on the prosecution of bankruptcy cases involving defendants who illegally concealed assets, filed fraudulent bankruptcy petitions, or otherwise abused the bankruptcy system. On February 29, 1996, Reno announced the indictment of 127 defendants under Operation Total Disclosure for their involvement in bankruptcy crimes between December 1995 and February 1996. Based upon the success of Operation

Total Disclosure, the Department of Justice will continue the intensified prosecution of bankruptcy cases involving fraud.

#### SEE ALSO

scams; Justice, Department of; bankruptcy fraud.

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## defective products

ACCORDING TO CONSUMER groups and the government agencies that are responsible for protecting Americans from defective products, more than 23 million defective products are likely being used by consumers in the United States alone. These products are considered defective because they have the potential to seriously injure or kill the users. The word "defective" is generally understood to mean imperfect or faulty.

The true extent of injuries and deaths that can be attributed to defective products cannot be reliably known, but experts agree that far more people are injured and killed from defective products each year than from all street crimes combined. Murder kills approximately 16,000 people per year and violent street crimes cause physical injuries to less than 1 million. The most common violent street crime is assault, which typically does not lead to any serious injury requiring hospital treatment.

It is known that even though more than 1,000 products are recalled each year, more than 20,000

people in the United States are killed annually by defective products. This number is understood to represent the minimum killed by defective products, for it excludes the 440,000 who die each year from tobacco-related illnesses, the more than 100,000 who die from adverse reactions to legal and approved drugs, the approximately 90,000 who die from eating high-fat diets (including large amounts of fast food products), and the 60,000 who die each year due to toxic chemicals.

An estimated 30 million Americans are injured by defective products, as well. For example, nearly 200,000 children require emergency-room care for toy-related injuries, and more than 2 million people suffer from serious reactions related to approved drugs. The Centers for Disease Control and Prevention (CDC) estimates that food-borne diseases, caused by pathogens such as listeria, salmonella, and toxoplasma, lead to more than 75 million illnesses, 325,000 hospitalizations, and 5,000 deaths every year in the United States. The total cost to American society attributable to injuries, deaths, and property damage caused by defective products is estimated to be more than \$500 billion every year. The direct costs of all street crimes combined is thought to be less than \$20 billion per year.

## TYPES OF DEFECTIVE PRODUCTS

Consumer protection agencies, such as Consumers Union, provide information on recently recalled products. The frequency with which products are recalled is simply stunning, and includes hundreds of cars, sports utility vehicles (SUVs), trucks and vans, and children's toys, dozens of appliances, lawn products, car seats, electronic devices, home improvement and home furnishing products, as well as several types of foods and beverages, drugs and health products, some household products such as automatic garage-door openers, and ironically, some safety products such as gun-trigger locks, carbon-monoxide and smoke detectors. Some defective products even involve those aimed at protecting police such as some bullet-proof vests, as well as some devices meant to protect society from criminals, such as electronic monitoring bracelets.

Tobacco use is the leading cause of preventable death in the United States, making cigarettes the most commonly recognized defective product in the United States, if not the world. Simply stated, cigarettes, a delivery device for the addictive drug of

nicotine, contain thousands of chemicals and more than 40 known and suspected carcinogens. Cigarettes are considered defective products by many because they kill and cause illness when used properly.

Studies of tobacco activities and internal documents of tobacco companies show that major tobacco corporations purposely misled the public and Congress for more than 40 years about the dangers of smoking cigarettes; they intentionally marketed to children and adolescents through product advertisements in magazines and on television; they increased the addictiveness of their products through adding nicotine and chemicals that heightened the effects of nicotine; they attacked and attempted to discredit anti-smoking advocates and whistleblowers; they lied under oath to Congress when asked about the addictiveness of their products; they financially coerced companies making smoking-cessation products; and they even intentionally funded and produced faulty science through their own Tobacco Institute to cloud the significant issues. While all this was going on, hundreds of thousands of Americans died every year from using the defective products manufactured and sold by tobacco companies.

In the late 1990s, major tobacco companies entered into a financial agreement with states to pay hundreds of billions of dollars in compensatory damages to states over dozens of years. The money was to be used for various purposes, including preventing youth smoking; in reality, the money has been used by states for various costs completely unrelated to smoking as they struggle with large deficits. Tobacco companies subsequently raised their prices and passed the costs on to their customers. Civil juries in some states have found tobacco companies liable for reckless disregard for human life, outrageous conduct, negligence, misrepresentation of the facts, fraud, and even selling a defective product.

Although food may be considered nature's products, the processing of food is definitely a corporate activity that can introduce defects into nature's supply. As for specific kinds of foods, meat was considered very unsafe before the 1970s despite several federal laws requiring safety and inspection standards. Even today, meat inspectors are understaffed and meat plants are only rarely inspected. In the late 1990s, the federal government declared that *e. coli* bacteria was an epidemic because it was so

widespread in the nation's meat. Part of the reason bacterial infections of meat are so common is because of how the meat is processed. Meat-packing plants run at a very fast and unsafe speed, increasing the risk of disease spreading from fecal matter and stomach contents of the animals to the carcasses. The speed of the assembly line also contributes to thousands of injuries of employees every year.

Automobiles are frequently found to be defective in one of two ways: first, there are design defects that are discovered by corporations and not fixed; second, corporations routinely resist safety devices until forced to adopt them by public demand. Examples of the latter include resisting putting in safety windshields and air bags. Yet, the most well-known case of a defective product involved a car that was known by its manufacturer to be defective but was not recalled to save the company money.

#### DEFECTIVE EXAMPLES

Perhaps the most well-known case of a defective product is the Ford Pinto. This automobile was manufactured in the 1970s despite the findings of pre-crash tests which showed that Ford knew of ruptured fuel lines being caused by rear-end collisions. Ford learned that it would cost \$11 per car to fix the automobiles but calculated that it could save \$87.5 million by not fixing the cars. This was based on the assumption that hundreds of people would be killed and injured and thousands of cars burned at minimal costs to the company. Ford underestimated the prevalence of the crashes and the size of the civil judgments against it.

More recently, the Firestone fiasco, as it has been called, led to dozens of deaths as consumers died when their Ford Explorers rolled over after their under-inflated Firestone tires exploded. Ford Explorers, like other SUVs with a high center of gravity, are prone to rollovers, whereas Firestone tires when under-inflated are prone to tread separation. The combination lead to deadly results. As claims were being investigated by the National Highway Traffic Safety Administration (NHTSA) and as a recall finally was issued and slowly implemented, deaths continued to occur.

Chief executive officers of both Ford and Firestone denied any wrongdoing or fault, and each pointed the finger at the other. Firestone tires on Ford Explorers were replaced in more than 10 other

countries almost two years earlier than in the United States, and the Ford Explorer was subsequently redesigned for "a smoother ride."

Internal company documents show that executives were aware of the problems and kept them secret, and that it took years for the problems to finally come to light. This is typical in defective products cases, including other automobiles such as General Motors (GM) approved conversion vans that become deadly when steel roofs are removed.

Other automobile deficiencies include defective seat belts and seat-belt buckles in some GM and Ford cars; faulty back-door latches in Chrysler minivans that open when struck from the rear or side and cause passengers to be thrown out on to the street; and GM side gas tanks located on the side of trucks outside of the protective frame that easily rupture when struck from the side. This latter product has caused more fatalities than any other defective vehicle.

In 1992, NHTSA asked GM to voluntarily recall pickup trucks with such gas tanks. GM refused and the Department of Transportation secretary found in 1994 that GM knew about the defect since the 1970s. GM entered into a deal with the Department of Justice to avoid a recall and has paid hundreds of millions in settlements to victims instead. Thousands of these vehicles are still on the road.

Another well-known case of a defective product is the Dalkon Shield, an intrauterine birth-control device inserted in millions of women in the 1970s. This device was dangerous because it allowed bacteria to enter the uterus, causing spontaneous and septic abortions, birth defects, and even deaths of women. The company which manufactured the product knew about it yet did not repair the product, replace it, or stop advertising it to women.

Another well-known device implanted in women is the silicone breast implant. The Food and Drug Administration (FDA) stated that the safety of these products was unknown even though they were already being used. Documents show that scientists worried about the safety of these products, and that the manufacturer had evidence of the ruptures that allow silicone to leak into the body causing serious illness long before such ruptures were widespread in the 1990s.

Similar claims were verified against the makers of the Rely tampon in the 1980s, which was found to lead to toxic shock in women who used them. Toxic shock produces fever, rashes, skin peeling,



low blood pressure, respiratory distress, shock, and even death.

With the exception of Ford, which was acquitted at trial in the Pinto case, the makers of each of the above products were ordered by courts to pay billions of dollars to compensate victims. No one went to jail or prison.

## EFFORTS TO PREVENT AND CONTROL

The Consumer Product Safety Commission (CPSC) is an independent federal regulatory agency that conducts research on products to determine which are hazardous. The CPSC also develops voluntary standards with industry, issues and enforces mandatory standards for product safety, bans consumer products that are proven unsafe, and informs consumers of product safety recalls and issues. It was created by Congress in 1972 to protect the public "against unreasonable risks of injuries associated with consumer products."

In 2003, the CPSC employed only 480 employees, which were responsible for monitoring the safety of more than 15,000 kinds of consumer products. Like most regulatory agencies, the CPSC has fewer employees and less money than in the past, because of deregulation of businesses by Congress in the 1980s.

The agency does not test products, nor recommend products, nor investigate any claims with regard to automobiles and vehicles, tires, boats, alcohol, tobacco, firearms, food, drugs, cosmetics, pesticides, or medical devices (these are the domain of other regulatory agencies, including the NHTSA, the U.S. Coast Guard, the FDA, and the Bureau of Alcohol, Tobacco, and Firearms (ATF)). The CPSC also does not investigate false advertising, fraud, or poor product quality unrelated to safety (this is the domain of the Federal Trade Commission, FTC) or claims dealing with work-related incidents (this is the domain of the Occupational Safety and Health Administration, OSHA).

The CPSC has more than 300 voluntary standards to be followed by business, plus about 50 mandatory regulations, and has a Disclosure Rule which requires that product manufacturers report defective products as soon as they are discovered if they pose threats to consumers. The key point is that most of their safety standards are voluntary and corporations are essentially allowed to police themselves.

NHTSA is part of the U.S. Department of Transportation and was created in 1970. It is the agency charged with reducing deaths, injuries, and economic losses resulting from motor vehicle crashes. NHTSA sets and enforces safety performance standards for motor vehicles and automobile equipment, and it investigates safety defects in motor vehicles. This agency also provides consumer information on motor vehicle safety topics, grants funds for state and local governments to assist them with conducting local highway safety programs, sets and enforces fuel economy standards, promotes the use of safety belts, child safety seats, and air bags, and conducts research on driver behavior and traffic to suggest safety improvements.

The FDA was created under a different name in the early 1900s and became known as the FDA in 1930. Its main responsibilities include ensuring the safety of food, cosmetics, medicine and medical devices, and some products such as microwave ovens. It also oversees feed and drugs for pets and farm animals. In 2003, the FDA employed more than 9,000 employees who were responsible for visiting more than 16,000 facilities annually.

Like NHTSA, the FDA operates mainly by voluntary recalls, but it also can, by court-order, force defective products from the market. The specific products it regulates include biologics (such as blood supply), cosmetics, radiation-emitting products (such as microwaves), and food products (except for meat and poultry which are regulated by the Food and Safety Inspection Service of the U.S. Department of Agriculture).

## WORTHLESS OR DEFECTIVE

Thousands of products which claim effectiveness for numerous ailments are sold over the counter and contain statements such as "these claims have not been evaluated by the FDA." One may wonder how many of these products have any worth at all. Such products are not typically considered defective except that they do not work as advertised. According to scholars, worthless products cost Americans approximately \$25 billion per year.

There are, in fact, entire industries built on fraudulent claims (for example, products that remove the appearance of cellulite and wrinkles, enlarge the penis, whiten the teeth, produce rapid weight loss, etc.). Some of these products have been shown to be not only ineffective but dangerous.

Regulatory agencies in the United States are understaffed and have great difficulty regulating the products within their jurisdictions. Essentially, regulatory agencies, such as the FDA, operate under the assumption of *caveat emptor*, or let the buyer beware. The burden rests on the consumer to avoid being injured or killed by defective products.

Because of deregulation by government of businesses that manufacture most products consumed, the sheer volume and variety of defective products is alarming. Manufacturers and distributors of these products also play significant roles. One example concerns the Ford Pinto. Ford executives met with President Richard Nixon in the early 1970s and asked the president not to issue an upgrade to the fuel tank standard that would have caused Ford to redesign its car. NHTSA didn't issue the new standard until 1974, and only after it was pressured from Congress, and the new rule did not take effect until 1977.

Congress has passed legislation aimed at strengthening reporting requirements of corporations to regulatory agencies, but since there is no corporate police force, the American people are counting on the corporations to be honest in policing themselves.

## CLAIMS MAKING BY MANUFACTURERS

Corporations that make consumer products have claimed in court that complying with federal product standards ought to provide a valid defense to criminal and civil charges related to claims of defective products; that is, businesses consistently claim that meeting minimum standards for product safety is sufficient.

Generally, this claim has been rejected, although companies have put pressure on Congress to accept so-called tort-reform legislation which would make it harder for injured plaintiffs to prove their cases because of such a defense. In fact, dozens of legal drugs, cars, trucks, SUVs, automobile safety features, and other products, meet federal safety standards but are still unreasonably dangerous. This is, in part, due to the fact that many product safety standards are outdated and minimal to begin with.

In the case of the Ford Pinto, it complied with minimal federal standards for safety (which dealt with front crashes) but was recalled after standards were expanded to rear crashes. The Ford Capri, sold at the same time in Europe, was designed to pass a

higher level of protection than the Ford Pinto. Its gas tank was located above the rear axle for years before American regulations required this placement in the Ford Pinto.

Ironically, modern studies of automobile collisions show that there are still minimal standards for post-collision fires and for impact resistance at some crash angles; automobile manufacturers know about these risks and work diligently to resist making changes to their cars. Hundreds of people die and thousands are injured every year in automobile crashes that could be prevented by tougher crash standards that are resisted by almost all automobile designers and manufacturers.

It has been alleged that other products, including some intended for the most vulnerable consumers such as children's safety seats, are defectively designed, shoddily manufactured, and inadequately tested by regulatory agencies. Similar claims have been made against some baby cribs. Such products produce thousands of deaths and hundreds of thousands of injuries annually in the United States.

As with the Ford Pinto, in many alleged cases of defective products, we consistently see attempts by corporations to withhold information from the public and to minimize potential harms posed by their products. It is also common for corporations to arrange secret settlements with victims that prevent other consumers from protecting themselves against defective products, and to delay payments when settlements are reached.

The dangers of defective products cannot be understated. Often, even after a recall, products end up back in the hands of additional consumers because they are resold by unknowing customers rather than being destroyed.

## SEE ALSO

Ford Pinto; breast implants; tampons and toxic shock; consumer deaths; Dalkon Shield; National Highway Transportation Safety Administration; Consumer Product Safety Commission Act; Food and Drug Administration.

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## defense industry fraud

THE DEFENSE INDUSTRY comprises the development, production and sale of weapons and weapons-support systems. In some cases, components or substances that are not themselves weapons may be classified as being part of the defense industry if it is believed that they may be used in the creation of weapons. The defense industry is characterized by oligopolistic conditions, in which a small number of large firms compete for a small number of orders from governments. Success in the industry relies upon, to a considerable extent, economies of scale from research and development departments, large-scale production facilities and good network contacts with relevant government officials, both domestically and internationally.

Many overseas sales are characterized by corruption and bribery and Transparency International has listed defense, along with the public works and construction industry, as being the sectors in which bribery is most rife. The very high value of products also provides an incentive for dishonesty, and the scale of the industry means that it retains a degree of momentum that is unlikely to be stopped by the pressure of external forces. That momentum was apparent at the Defense Systems and Equipment International (DSEi) exhibition which continued in London during, and for several days after, the September 11, 2001, terrorist attacks against the United States.

### VARIETY OF FRAUDS

Incidences of fraud in the defense industry fall into the following categories:

*Illegal sale or supply of arms.* Illegal sales include arms-producing equipment to states under sanctions or otherwise in contravention of international trade laws. Well-known examples of this include the export sale by the United Kingdom (UK) company Churchill Matrix of components designed to create a Super Gun for Saddam Hussein's regime in

Iraq; similarly, the Iran-Contra affair involved the complex exchange of arms for hostages in Iran and Nicaragua, which remains an operation in which the culpability of various members of President George W. Bush's cabinet remained contested.

*Bribery.* This kind of activity involves bribing officials to make arms purchases which are uncompetitive or else unnecessary. Repeats of sales in the Persian Gulf by UK firms reveals that bribery is considered an essential aspect of doing business in this industry. The notorious Al Yamamah arms sale has been the subject of a number of lurid allegations, including bribery, the provision of prostitutes, and other immoral and illegal inducements. This is not the only example, as related deals, some with the alleged involvement of senior politicians of the UK government, also featured bribery and diversion of public moneys together with the unnecessary purchase of arms equipment.

*False records.* This kind of defense industry fraud involves government officials purchasing in ways that enrich themselves rather than in the public interest, or else falsifying public records to hide the extent of arms purchases. This occurs in countries, such as Myanmar, in which the military government is faced with numerous allegations of human rights abuses and wishes to conceal its need to keep the populace in a state of fear.

*Collusion.* Too-close relationships between buyers and suppliers lead to accusations of collusion and purchase of influence. In the defense industry, this danger is especially prevalent in that the need for joint development of new products, as well as specialized strategic and weapons knowledge, makes the transfer of personnel between industry and government a common phenomenon. This relationship has intensified in the United States in the second half of the 20th century, and has come to be known as the military-industrial complex.

*Unlicensed trading.* This form of criminality involves the illegal trading in weapons by unlicensed people and organizations. Particularly in places close to war zones, areas with porous borders or in which previous militaristic regimes have been displaced, there may be large numbers of weapons in circulation and these may come under the control of criminal gangs who require them for their own activities, or who may trade them with terrorists, rebels or other groups willing to use violence to achieve their aims. Thailand, for example, is, unfortunately, an ideally placed country for an illegal

arms trade featuring materiel from Cambodia, Myanmar, Laos and with equipment still available from the U.S.-led war in Vietnam.

*Irrationality.* Illogical and possibly illegal purchasing procedures can result in needless expenditure on goods and services. This has become particularly well-known as a result of exposures about activities within the U.S. government's Pentagon, which controls military expenditure, although the greater freedom of information in the United States probably hides the fact that such abuses occur in most countries. Problems with Pentagon purchasing policies became well-known as a result of Ernest Fitzgerald's book *The Pentagonists*, in which it was revealed that government would pay as much as 1000 percent mark-ups on simple items of equipment as a result of irrational policies.

Additional concerns relevant to the defense industry, but not directly related to fraud, include the unsafe testing of arms and the expropriation of territory both domestically and internationally to acquire testing grounds; the lobbying of governments by arms industry representatives with a view to persuade them to abrogate international agreements that might save civilian life (for example, land mines) or otherwise becoming unduly involved in the political process; making products knowing that they may not conform to standards of international law, and more general abuse issues.

## THE LEGAL SITUATION

The defense industry, and weapons-trading generally, are regulated by a number of international laws. These include, in the case of the transfer of arms with the knowledge that they may subsequently be used in ways not damaging to humanitarian practices or serious violations of international human rights, Chapter VII of the United Nations Charter, Common Article 1 of the 1949 Geneva Convention, and Draft Articles of the International Law Commission.

In the event of the misuse of weapons by private individuals when the state has failed to exercise due diligence, relevant regulations are applied by the European Court of Human Rights, Article 6 of the International Covenant on Civil and Political Rights, and Article 3 of the Universal Declaration of Human Rights.

Unfortunately, as of early 2004, it appeared that the world generally is moving away from multilateralism and the observance of global legal agreements.

The withdrawal of the United States from a number of important international treaties, the collapse of World Trade Organization talks, and international tensions arising from the War on Terrorism, among other developments, suggest that the ability of individuals or of governments to apply the international legal system to regulate the defense industry will not be stronger in the future.

In the United States, the defense industry has realized these difficulties and have taken steps to reduce improper practices. In 1985, President Ronald Reagan appointed David Packard, chair of the Hewlett-Packard Corporation and a former deputy secretary, to chair the independent Commission on Defense Management. The commission was charged with reviewing procurement, budgeting and operating procedures within the U.S. defense system, and with making recommendations for improvements to that system.

The commission preferred to recommend a system of self-regulation rather than governmental control, which was a finding consistent with the conservative ideology of the Reagan administration. Defense contractors were, therefore, required to develop and implement codes of ethics that addressed the issues of the industry.

Defense contractors met subsequently and adopted industry standards that covered such issues as codes of ethics, internal reporting of possible wrongdoing procedures, self-governance mechanisms and responsibility to the public. This came to be known as the DII (Defense Industry Initiative) Principles. Inevitably, the DII Principles have been examined in court and modifications have been made. They have also been refined through a series of forums and workshops at which leading defense industry executives have been in attendance.

Further, the appointment of Packard and the acceptance that self-regulation would provide an adequate means of ensuring the industry remained appropriately controlled have been widely criticized as representing the surrender of authority from government to industry.

## FUTURE PROSPECTS

The changing nature of foreign policy means that weapons and weapon systems sold today, in what appears to be good business practice, can become unfortunate or even criminally negligent tomorrow.

For example, British troops came under fire from French Exocet missiles in the Falklands War, missiles sold to Britain's enemy, Argentina, a few years before. Another, more forceful example, is the American arming of Muslim extremists in Afghanistan to resist Soviet troops who had invaded. This policy appeared less coherent when the extremists then formed the Taliban government in Afghanistan which helped to enable the rise al-Qaeda terrorists. Moreover, attempts to enforce an ethical foreign policy can founder as a result of the need to sustain jobs, skills and competencies in a high value-added industry of considerable strategic importance.

It appears that future advanced weapons systems will continue to be increasingly capital- and research-intensive. This continuing development in the military-industrial complex is likely to represent a continuing trend concentrating production into a small number of advanced firms, possibly with cross-border governmental support, as in the case of the European Union, and rivaled by new and emerging regional groupings.

#### SEE ALSO

General Dynamics; accounting fraud; government procurement fraud; bribery; government contract fraud; Iran-Contra; bribery.

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## differential association

DEVELOPED BY criminologist Edwin H. Sutherland, differential association theory has been one of the most long-lasting sociological and criminological theories of our time. Sutherland described his differential association theory in his book, *Principles of Criminology*, published in 1939.

The theory's popularity, in part, stems from its simplicity and straightforwardness. In particular, his views on the causes of crime can be found in the nine propositions he described:

1. Criminal behavior is learned
2. Criminal behavior is learned in interaction with other persons in a process of communication
3. The principal part of the learning of criminal behavior occurs within intimate personal groups
4. Learning criminal behavior includes learning the techniques of committing the crime, which are sometimes very complicated and sometimes very simple, and learning the specific direction of motives, drives, rationalizations, and attitudes
5. The specific direction of motives and drives is learned from perceptions of various aspects of the legal code as being favorable or unfavorable
6. A person becomes criminal when he or she perceives more favorable than unfavorable consequences to violating the law
7. Differential associations may vary in frequency, duration, priority, and intensity.
8. The process of learning criminal behavior by association with criminal and anti-criminal patterns involves all of the mechanisms involved in any other learning
9. While criminal behavior is an expression of general needs and values, it is not excused by those general needs and values since non-criminal behavior is also an expression of the same needs and values.

Differential association theory suggests that criminal behavior is learned through the process of communication in small groups. Sutherland noted that individuals need to learn strategies to commit crime and reasons to commit crime. With this assumption as a framework, Sutherland argued that individuals will learn definitions of laws as favorable or unfavorable. Those who think laws are fair will be more prone to abide by the laws, while those

who see them as unfair will be less prone to engage in appropriate acts.

In addition to one's perceptions about laws, Sutherland also pointed out that the same learning process that is used to learn conventional behavior is used to learn criminal behavior. For example, individuals use the same process to learn how to use a computer for their job that computer criminals use to learn how to use a computer to perpetrate a crime. He also believed that criminal behavior is not caused by needs or values, because all behavior stems from needs and values.

Although Sutherland developed his theory to explain all criminal behavior, he took several opportunities to illustrate how his theory explains white-collar crime. Consider the following comments from Sutherland (1983):

White-collar criminals, like professional thieves, are seldom recruited from juvenile delinquents. As a part of the process of learning practical business, a young man with idealism and thoughtfulness for others is inducted into white-collar crime. In many cases, he is ordered by managers to do things he regards as unethical or illegal, while in other cases he learned from those who have the same rank as his own how they make a success. He learns specific techniques of violating the law, together with definitions of situations in which those techniques may be used.

Elsewhere, Sutherland quoted a shoe salesperson who learned the rationale for selling misfitting shoes from his manager: "[The manager told the salesperson] my job is to move out shoes and I have you to assist in this. I am perfectly glad to fit a person with a pair of shoes if we have his size, but I am willing to misfit him if it is necessary in order to sell him a pair of shoes. I expect you to do the same. If you do not like this, someone else can have your job. While you are working for me, I expect you to have no scruples how you sell your shoes."

This quote from Sutherland epitomizes his theory. The salesperson learned how to commit the misdeed and why to commit the misdeed. Sutherland's theory has withstood the test of time and the scrutiny of sociologists and criminologists. Several tests have supported the assumptions of the theory, but the fact that it is difficult to test the specific assumptions set forth by Sutherland has been levied

as one of the common criticisms of differential association theory. Still, the research and policy implications that have evolved out of his theory is a testament to the theory's importance and strength.

#### SEE ALSO

Sutherland, Edwin H.; Cressey, Donald; critical theory; conflict theory.

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## direct-mail fraud

**ALSO KNOWN AS** direct marketing, direct mail is a form of advertising in which companies send large numbers of printed mailers, generally numbering in the millions per campaign, through the U.S. Postal Service or another mailing venue to potential customers. Direct-mail fraud results when a deceptive or misleading offer is sent to consumers via a mass mailing that causes the consumer to remit money for a product or a service with unwarranted or false expectations.

In a 1999 United States General Accounting Office report, the Federal Trade Commission (FTC) defined mailed material as deceptive, "if the material included a representation or practice or if the material omitted information that caused a consumer to be misled and eventually suffer some loss or injury, despite the fact that the consumer behaved reasonably under the circumstances."

In recent years, the scope of understanding of direct-mail fraud has expanded to encompass other methods of mass mailing, such as faxes and bulk mailing using e-mail addresses, also known as spamming. The practice of using fax for mass mailing is closely related to direct mail in its potential for fraud and other problems; only the venue for distributing the mailing is different. But mass mailing to e-mail accounts is exponentially more hazardous when the claims in the e-mail are in some way deceptive or misleading, because of the great numbers

of people that can be reached in a short period of time, and the speed at which these kinds of false claims can have an effect.

Statistics about direct-mail fraud and its impact on consumers reveal that it has a broad effect at all levels of contemporary American society; indeed it might be argued that it is the most likely form of business fraud to have a measurably damaging effect on consumers. Consumer concerns and complaints are usually submitted to the FTC and/or the Postal Inspection Service of the U.S. Postal Service. Both organizations are active in combating direct-mail fraud; the FTC is responsible for fair trade practices and the Postal Service is usually the vehicle for the fraud.

### PROJECT MAILBOX

In yearly investigations of direct-mail fraud, dubbed "Project Mailbox" and which began in 1997, an oversight organization formed from the FTC, the Postal Inspection Service, the Securities and Exchange Commission (SEC) and the National Association of Attorneys General (NAAG) identified the greatest number of illegal activities as deriving from deceptive sweepstakes and prize promotions, with travel, investment, and various other scams following in that order.

In 1999, at the behest of the U.S. Senate, the General Accounting Office launched an investigation of deceptive mailing practices. It conducted its own surveys as well as used the evidence collected by the FTC and the Postal Inspection Service. The evidence strongly supported lawmakers and consumers' perception that direct-mail fraud was widespread, and suggested that its effects differed according to social or economic status. In the six months prior to the survey, 51 percent of those questioned had received a sweepstakes promotion or look-alike cashier's check that was misleading or deceptive.

The higher the education levels of the person surveyed, the more likely they were to assert that they had received deceptive mail. Of respondents with an college degree or higher, 62 percent indicated that they had received such mail, while 56 percent of respondents with some college education indicated that they had, and only 43 percent of respondents with high school education or less believed that they had received deceptive mail. Similar variations in response were reported by those with

different income levels, with respondents having higher income more likely to report that they had received a deceptive or misleading mail offer.

### SWEEPSTAKES

The majority of instances of direct-mail fraud occur with sweepstakes offers. A sweepstakes is a promotion that a consumer may enter through the mail in hopes of winning a prize, which is usually money. The use of direct-mail sweepstakes offers is a legitimate business marketing practice; it is intended to generate publicity and excitement about a product.

For example, magazine subscriptions are often touted using sweepstakes. By law, purchase of the product associated with the sweepstakes offer is not necessary to enter the contest. Though there are legitimate sweepstakes offers from organizations that do award prizes, lawmakers and consumers have strenuously objected in the past to the wording of the mailings even of these legitimate contests. It is not always made clear in the advertising material what the odds of winning the contest are, and that purchase of the products advertised does not increase the odds of winning.

The letter may indicate, for example, that the consumer has "already won," though the "winner" will discover only after reading the small print that this is not actually the case. The mailed material may also suggest that the consumer pay an extra fee for "expedited processing," and indicate that "winners usually do buy" the product advertised. The deception is in the implication that either of these tactics will increase the consumer's chances of winning the contest, which they will not.

In addition to such misleading language, the direct-mail sweepstakes industry is plagued by small, fly-by-night companies that engage in fraudulent and deceptive business practices. For example, companies may claim to be running a contest but do not in the end, after collecting entries and money actually, offer any prizes. In many of these sweepstakes offers, the information provided regarding the product to be purchased is also deceptive.

A common product is a "cash folio." This product description is misleading, because the product is in reality a coupon book that likely will have very little cash value for consumers who may not need the items that can be redeemed with the coupons. In addition, the coupons require even more outlay of

money by the consumer. Consumers who purchase these cash folios likely are motivated not by the attractiveness of the product, but rather by deceptive language in the mailing that implies that purchase of the coupon book will increase the odds of winning the sweepstakes. These sweepstakes companies may also use a number of different names to promote the same contest. For example, customers may receive three different mailings under three separate corporation names, and are misled into thinking that they are entering three separate contests when it is, in reality, only one contest with only one set of prizes.

### UNCLAIMED PROPERTY

Charging consumers for otherwise free government services is another common variety of fraud perpetrated through direct mail. A consumer may receive a mailing that lists for the return address a seemingly official name, such as "State Property Division." The inside material then describes "unclaimed property" belonging to the recipient that can be retrieved for a fee. This claim is misleading both in the implication that the company is somehow official or a governmental unit, and second in its claim that money must be sent to retrieve unclaimed property, because state governments do not charge for this service. These government look-alike mailings are often targeted toward the elderly, because this demographic may be easily confused by government-alike company names.

Direct-mail fraudsters also take advantage of the intimidation many elderly consumers feel when navigating the bureaucracy of government programs, such as Social Security, and suggest in their direct-mail material another route for reaching government offices that seems simpler. For example, a mailing may suggest that the consumer call to obtain Social Security information using a 900 number, and not reveal that a call to a 900 number is a very expensive toll call or that the government would never charge to make this information available to consumers.

### SCHEMES AND SCAMS

One kind of direct-mail fraud incites further fraud. Ever-popular envelope-stuffing schemes advertise that consumers may work at home and have the freedom of being their own boss. Interested cus-

tomers remit a fee to the company allegedly for equipment; it is usually very expensive. In these fraudulent offers, it is implied that the consumer can then stuff envelopes at his or her leisure and sell them to companies. But it is often the case that dishonest companies send nothing in return for the customer's fee, or simply send instructions for beginning an envelope-stuffing business. Alternately, the consumer may be sent material with instructions for how to send out more envelope-stuffing offers, perpetuating the direct-mail fraud by using unsuspecting consumers.

E-mail provides a convenient venue for the rapid dissemination of direct mail, and not surprisingly e-mail direct marketing, as with traditional direct-mail marketing, has been vulnerable to fraudulent offers and claims. One such direct-mail fraud was conducted under the name AOL Investment Snapshot—a name intended to suggest (falsely) that the company was tied to the legitimate company, America Online. The e-mail, an investment scam, recommended the purchase of particular penny stocks. The stocks were, as a result, driven higher in value in that day's trading, and the stock promoter who sent the e-mail benefited by selling his stocks.

The speed with which direct e-mail marketing may have an effect has its danger in the rapidity in which fraudulent activity can be executed. For example, an e-mail sent under a disguised name may send a stock price soaring, during which time the promoter sells her stock and cashes out. The fraud need not take more than a couple of hours and is difficult to track. This kind of manipulation of stock prices for financial gain through direct e-mail marketing is prosecuted by the SEC, which is responsible for ensuring the integrity of financial markets.

Other deceptive practices involving direct mail include loan solicitations ("payday advances" that fail to clearly indicate membership fees, high cash-advance fees, and that advances can only be used for the business's catalogue shopping); insurance scams; and offers to help consumers patent their inventions. Another common form of direct-mail fraud involves checks that look real, and that consumers mail in with a processing fee in the hopes of obtaining a real check. Vacation scams are another form of direct-mail fraud. In these cases, the customer is offered a free vacation, but when she contacts the company to redeem the vacation, she is



informed of fees generally totaling several hundred dollars, or it is revealed that attendance at a time-share sales presentation is required. And it is not just regular consumers who are victimized by direct-mail fraud: businesses can also be targets of fraud, for example with "Yellow Pages Invoices" that ask for payment to "renew" listings in business directories that are not distributed to the public or associated with the local telephone directory.

Companies that commit direct-mail fraud often target particularly vulnerable consumers, such as the elderly. Senior citizens may be less diligent or watchful about the kinds of programs in which they will participate, and may be more easily confused about misleading claims made in direct mailings. Direct-mail fraud is an exponential problem for victimized consumers, because once they purchase a product through a fraudulent sweepstakes offer or otherwise send money as a result of a deceptive direct mail pitch, they are re-solicited again and again by the same company. The names and addresses of consumers who have been shown to be receptive to mail sweepstakes or other offers are also sold to other direct-mail companies.

## OVERSIGHT AND PROSECUTION

It has been difficult in the past to prosecute businesses that engage in direct-mail fraud. One barrier is that jurisdiction usually belongs to individual states, and differing laws and regulations mean that investigation and prosecution practices are not uniform from state to state. Also, companies that engage in direct-mail fraud have strategies to avoid authorities. They may only set up a bare-bones operation so that they can close up at the first sign of investigation; move from state to state to avoid prosecution by attorneys general in particular states; and operate different mailboxes in different jurisdictions.

By the time a consumer files a complaint against a company that has perpetrated direct-mail fraud, the company will likely be in another state and operating under another name. Direct-mail fraud is also difficult to prosecute because it requires consumer complaints, often by consumers who must admit that they have been taken in by misleading or deceptive claims.

Direct-mail businesses have an industry oversight group that works to educate businesses about criminal activity, the Direct Marketing Association.

It is a nonprofit trade organization, established in 1917, meant to advise its members on practices in the direct-marketing business. Because fraudulent offers taint the reputation of all direct-mailers, it is crucial to the business of the legitimate companies that they eradicate fraud. The DMA recently issued nine guidelines for e-mail marketing to attempt to improve the integrity, accuracy, and reputation of this much-maligned practice.

In February 1999 the NAAG met to strategize how to combat sweepstakes fraud. The NAAG recommended the following voluntary guidelines for the direct-mail sweepstakes industry: 1) the odds of winning must be clearly disclosed; 2) there should be no implication that purchase of a product increases the chances for winning; 3) there must be a simple and uniform way to enter the contests both for consumers who purchase products and those who do not.

The FTC has focused on education of consumers, using catchy slogans such as "Catch the Bandit in the Mailbox" to help alert consumers to potential fraud. In July 1998, the FTC named a Dirty Dozen, twelve scams that were disseminated to the public using bulk e-mail. The fraudulent activities described in the FTC's Dirty Dozen were not necessarily new; rather it was the venue that was new and the number of consumers that could be reached and deceived by these scams in a short time. In addition, the FTC established a toll-free hotline (1-877-FTC-HELP), and used its website ([www.ftc.gov](http://www.ftc.gov)) to make information available to the public about deceptive mailings.

Various states have also undertaken measures to protect consumers from direct-mail fraud. The Colorado Sweepstakes and Contests Law, passed in 2000, mandates that sweepstakes companies reveal the odds of winning and prohibits them from indicating that the recipient is specially selected or has already won a prize.

These educational and enforcement initiatives culminated in federal intervention. Congress took action against direct-mail fraud in 1999 with the passage of the Deceptive Mail Prevention and Enforcement Act. It prohibits mailings that use names that suggest that the company is associated with the U.S. government or Postal Service or otherwise misrepresent the true identity of the mailer, as well as mailers that mislead the consumer by suggesting that government services will be affected by purchase of a product. It also has particular disclosure

requirements for sweepstakes offers, contests, and look-alike cashiers' checks. Broader authority was given to the U.S. Postal Service to stop deceptive mail and to pursue offenders.

The Free Speech Coalition (FSC) objected to this legislation on behalf of businesses that use direct mail with fair and honest business practices, particularly nonprofit organizations that rely heavily on direct mail for fundraising. The FSC registered concern that the new legislation increases too dramatically the enforcement power of the Postal Service. The FSC notes that it allows the Postal Service to use its own discretion to determine which mass mailing material is appropriate, and to immediately stop any item that it deems inappropriate. If mistakes are made by the Postal Service with regard to legitimate mail being stopped, the damage will have already been caused to the business of the organization. The FSC also claims that the new legislation will deny direct mailers due process by allowing the Postal Service (itself a business) to levy fines.

Also a problem, according to the FSC, is the intervention of the federal government at all in a business that is already heavily regulated by states and local governments. Direct-mail organizations argue that prosecution of fraud within their industry must be done at a level that targets only companies that engage in dishonest practices, without destroying or unnecessarily limiting the direct mail advertising of legitimate companies.

#### SEE ALSO

advertising fraud; scams; Federal Trade Commission; Securities and Exchange Commission; internet fraud; wire fraud.

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## Domhoff, G. William (1936–)

G. WILLIAM Domhoff is a retired research professor at the University of California, Santa Cruz, who continues to write about his interests in both psychology and sociology. In psychology, his focus is the scientific study of dreams. However, this prolific social scientist's most prominent contribution can be found in sociology, specifically in the area of the power structure in the United States.

Domhoff's perspectives about power relations in society can be traced to the work of economist Paul Sweezy, political scientist Robert Dahl, sociologists E. Digby Baltzell and Floyd Hunter, and especially the maverick political sociologist C. Wright Mills. From Mills, Domhoff borrowed the concept of the power elite, a ruling group who controls power in society by dominating the business, military, and governmental institutions. In Domhoff's conception, however, the elites are a cohesive group of people from the top social and economic strata in America.

Domhoff began his thesis with *Who Rules America* in 1967, a work that became a pioneering landmark in political sociology. The power elite, according to Domhoff's conceptualization, is a homogenous unit whose high level of cohesion can be traced to attendance at prestigious preparatory school and Ivy League institutions, membership in higher social circles and elite clubs, similar recreation patterns, and a common world view. The power elite maintains this cohesion despite the "antagonisms" of varying religious and ethnic backgrounds, political affiliation, and the dichotomy of old-versus-new money. This group, the seat of power in the United States, exerts an enormous influence on the business sector, the government, and various regulatory agencies.

After an elaboration on this theme in other works that focused more on the issue of upper class domination, Domhoff published an often cited study of upper class social clubs (which he called "watering holes"), the Bohemia Grove club, the



G. William Domhoff co-authored *Diversity in the Power Elite*, which explores the issue of diversity in American society as it relates to entrance into the circles of the power elite.

Rancheros Visitadores (visiting ranchers), and the Roundup Riders of the Rockies. In this work, *The Bohemian Grove and other Retreats*, he posited that clubs that focus on recreation also play a pivotal role in making the higher circles an elite and cohesive group.

From the 1970s onward, Domhoff completed a series of works that examine the power elite from the macro level of analysis he used in *Who Rules America*. These works focus particularly on the issue of how the political landscape is molded by the power elite. Along with Richard L. Zweigenhaft, Domhoff continued his exploration of power structure by including the variables of race in *Blacks in the White Establishment* in 1991, and a follow-up report *Blacks in the White Elite* in 2003.

Another recent work, *Diversity in the Power Elite*, explores the issue of diversity in American society as it relates to entrance into the circles of the power elite. Despite some major changes in upward social mobility by women and other minority populations, Domhoff and his colleague Zweigenhaft concluded that the new diversity created little change in the overall structure of the higher circles.

Domhoff continues to research aspects of power structure as well as his psychological interests. It is likely that, other than C. Wright Mills (and of course, Karl Marx), no other person has made more significant contributions to the study of class and power elitism than Domhoff.

#### SEE ALSO

elite crime; military industrial complex; differential association; self-control theory; Sutherland, Edwin H.

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## Dow Chemical

AS OF 2002, the Dow Chemical Company was one of the world's largest diversified chemicals and plastics companies with sales of \$27.6 billion, employing approximately 50,000 people worldwide. The company supplied more than 3,400 chemical and plastic products to 170 countries.

Dow achieved notoriety during the 1960s as a supplier of napalm and the defoliant Agent Orange to U.S. armed forces serving in Vietnam. The "Dow Shall Not Kill" campaign was central to the development of the anti-war movement in the United States. During the 1980s, American Vietnam veterans sought damages from Dow and other manufacturers of Agent Orange because they alleged exposure to dioxin in Agent Orange had adversely affected their health. Campaigners also pursued the company through the courts for dioxin contamination, and poisoning the Great Lakes with mercury.

After a merger with the Union Carbide Corporation in 2001, Dow assumed Union Carbide's liability for asbestos-related claims. The company estimates that the cost of resolving pending and future claims during the period 2002-17 will be between \$2.2 and \$2.4 billion. The company is also potentially liable for claimed defects in breast implants and other silicone medical products, personal injury, and property damage caused by some chemical pesticides containing dibromochloropropane (DBCP), and the remediation and restoration of polluted manufacturing sites.

Formed in 1897 by Herbert Dow, the Dow Chemical Company produced chlorine bleach from waste brine from the Midland Chemical Company plant, an early venture. By 1900, the company had absorbed Midland Chemical and was an established chemical producer by 1910. The outbreak of World War I removed German competition in the U.S. market, and Dow expanded into the manufacture of dyestuffs.

The company poured money into research to maintain market leadership when the German chemical industry revived during the 1920s. Several new products entered the company portfolio as Dow Chemical followed a policy of progressive organic growth.

The demands of the U.S. military during World War II boosted the company still further. The company also began to expand internationally, forming Dow Chemical of Canada in 1942. During the fol-

lowing decade the company entered the important Japanese and European chemical markets. The story of Dow as a growth company came unstuck in the late 1960s and early 1970s.

In the summer of 1970, Dow stumbled into another controversy when the attorney general of Ohio asked the U.S. Supreme Court for leave to bring an action against Dow for mercury pollution. In 1969, a Norwegian graduate student published a research paper showing that mercury deposited in the Great Lakes could accumulate in the bodies of fish as highly toxic compounds. People eating large quantities of mercury-tainted fish risked severe mercury poisoning. Like other chemical and paper companies, Dow Canada flushed mercury spilled at manufacturing sites around the Great Lakes into the nearest body of water, believing that the mercury sank to the bottom and remained inert.

The government of Ontario, Canada, had already instituted proceedings against Dow Canada for mercury pollution during the spring. When commercial fishing was suspended, fisherman made individual claims and class-action claims for loss of livelihood. In 1985, Dow Canada faced a similar scandal after a government diver reported discovering a blob of perchloroethylene, a dry cleaning fluid, while sampling sediments in the St. Clair River during 1984.

The Ontario Ministry of the Environment prosecuted the company for spilling perchlor. Dow Canada pleaded guilty and undertook to clean up the river. As of July 1998, Dow was a potentially responsible party for 38 sites on the Superfund National Priority List, the U.S. government's toxic clean-up program.

### QUESTIONABLE PAYMENTS

During the 1970s, Dow Chemical also struggled with mounting public concern about bribery and "facilitation payments" in the United States. The treasurer of the company appeared before the U.S. Senate Select Committee on Presidential Campaign Activities to inform them that 76 Dow executives made personal contributions to individuals on a list of political candidates favorable to company interests drawn up by the tax counsel.

Although Dow had not made illegal donations, the public outcry about illegal campaign donations and later revelations about U.S. companies bribing foreign government officials prompted Dow to con-

duct an internal investigation of questionable payments made by employees.

The investigation revealed that senior managers of Grupo Lepetit, an Italian-based subsidiary manufacturing pharmaceutical products, were making questionable payments to secure contracts. Dow stopped these facilitation payments and adopted a new company policy explicitly forbidding payments.

## AGENT ORANGE

Dow's problems caused by antitrust, environmental, and anticorruption legislation paled in comparison with the furor over Agent Orange. Between 1962 and 1971, the U.S. military sprayed Vietnamese forests with 20 million gallons of herbicide in an effort to kill unwanted plants and defoliate trees provided the Viet Cong and North Vietnamese Army with cover. Although the military used 15 different herbicides in Vietnam, over 80 percent of the herbicides sprayed were Agent Orange. One of the chemicals in Agent Orange contained traces of TCDD or dioxin. This impurity was linked with several types of cancer and other disorders.

Dow was the largest supplier of Agent Orange to the U.S. military, opening the company to personal injury claims from civilians and military personnel exposed to the herbicide. In 1969, the federal government restricted the use of Agent Orange to sparsely populated areas in the United States, and ceased using it in military operations in 1971. Dow refused to accept that there was a link between dioxin-contaminated Agent Orange and cancer. However, stringent regulations made the business unprofitable for the company which mothballed the plant producing Agent Orange in 1979 before decommissioning it in 1983.

More than 17,000 U.S. Vietnam veterans claimed disability payments relating to Agent Orange from the Veterans Administration. By 1984, 9,600 of the claimants had been hospitalized and 1,300 claims had been paid. In 1979, 9,000 veterans took the manufacturers to court, seeking \$44 billion in compensation. At the time, the case was the largest product liability case ever and the first mass tort class action. In an out-of-court settlement, the seven major producers of Agent Orange agreed to establish a \$180 million compensation fund for veterans. The veterans' lawyers accepted the settlement

after the judge warned the lawyers that their evidence was weak and that the case might drag on for years. The federal government and the manufacturers have since been accused of manipulating scientific evidence to refute the existence of a link between exposure to dioxin-contaminated Agent Orange and subsequent health problems.

According to company historian Ned Brandt, disabled veterans received from \$256 to \$12,800 and the families of deceased veterans from \$340 to \$3,400 in compensation. Approximately 39,000 veterans received money from the fund while 28,000 claims were rejected. When the 10-year period for making claims ended in 1995, \$21 million remained in the fund. Veterans and their families continue to file lawsuits against Dow and other manufacturers of Agent Orange as the original settlement excludes veterans who began to suffer the effects of exposure to dioxin after 1994.

## SEE ALSO

water pollution; air pollution; Union Carbide; Vietnam War; class-action lawsuits; corporate liability.

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## Drexel Burnham Lambert

THE JUNK BOND kingdom of financier Michael Milken, of Drexel Burnham Lambert, was raking in

enormous profits during the boom of the 1980s. The boom had begun when Drexel offered to buy the telephone company MCI for \$1 billion. Within a few years, however, a notorious insider-trading scandal sent Drexel into bankruptcy and Milken to prison. Milken and Drexel had used junk bonds, high-yield bonds issued on high-risk companies, to rescue small companies that were going under because they could not get loans from traditional sources. It was later revealed that Drexel's customers were purchasing both original and secondary securities from one another. Drexel's customers were also being encouraged to buy securities that Drexel felt were crucial to its own success. What appeared to be huge profits for Drexel often came from money being shifted around within the company.

Many of Drexel's clients had gone bankrupt, lacked a credit history, or had insufficient capital. In the past, the only resource for such companies had been to negotiate short-term loans from banks or through private placements with insurance companies that offered highly restrictive stipulations on the loans. Drexel offered to underwrite loans on these high-risk companies with few or no restrictions; and in return, the companies paid high yields to investors and enormous fees to Drexel. Drexel had also discovered that their highest profits came from acquisitions and mergers, particularly from leveraged buyouts in which public companies were taken private. Surprisingly, the junk bond business was relatively free of government regulation, even though the industry handled trillions of dollars.

## PREDATOR'S BALLS

Beginning in 1979, Drexel hosted an annual convention that came to be called the Predator's Ball since the purpose of the meetings was to bring high-risk companies with bonds to sell together with investors who were willing to take the necessary risks. By 1984, the convention had developed into a wild party, which was attended by individuals with a combined purchasing power of \$3 trillion. In 1985, Drexel hosted its sixth annual Predator's Ball, which lasted for four days. No expense was spared on food and drinks, and the entertainment was provided by the legendary singer Diana Ross.

The 2,000 or so well-heeled investors included an A-List of corporate raiders and other corporate mavericks who bought junk bonds for insurance

companies, pension funds, savings and loans, and other institutions. In 1990, Drexel canceled the Predator's Balls, creating huge financial losses for the industries that had provided service for the ball and its attendees.

Drexel was plunged into hot water in May 1986 when both the Securities and Exchange Commission (SEC) and federal prosecutors filed charges against Drexel employee Dennis Levine for allegedly earning \$12.6 million in illegal profits from insider trading. The official charge against Levine was that he had been involved in a scheme "to buy and sell securities based on non-public information gained through his employment as an investment banker for five years." Levine was later sentenced to three years in prison and served 17 months. He was also required to pay \$11.6 million in fines and penalties.

Drexel announced that it would cooperate fully in all investigations. Levine's arrest was the first in a series that would ultimately bring down Drexel, the largest seller of junk bonds in the country. The investigation into the dealings of Drexel signaled an end to what had become known as "the greatest money-making boom in Wall Street's history." By the time ensuing investigations were over, a number of financial wizards were sent to prison, billions of dollars in fines would be levied, thousands of investors lost their funds, and careers and families were destroyed. As the Drexel Burnham Lambert scandal unfolded, hundreds of investors filed civil suits against the company and against Milken.

One of Milken's colleagues, Ivan F. Boesky was able to move billions of dollars in stocks with a few telephone calls from his office at Drexel. In November 1986, Boesky agreed to pay \$100 million in fines to settle charges of insider trading and promised to help the government go after other members of Drexel Burnham Lambert in an undercover operation. Boesky was especially helpful in bringing attention to Milken. For example, he pointed investigators toward a phony invoice that had resulted in a \$5.3 million payment to Milken and Boesky for "consulting services."

Once investigators felt confident of their cases, Milken and Drexel Burnham Lambert were subpoenaed. Boesky was sentenced to three years in prison for his part in the insider-trading scandal. In 1987, the case took an even more bizarre twist when John Mulheren, a manic-depressive and Boesky's best friend on Wall Street, was arrested for trying to kill

Boesky. Mulheren was convicted in July 1999, but the conviction was later overturned, allowing Mulheren to return to Wall Street.

In September 1988, the SEC formally charged Drexel Burnham Lambert and several individuals within the company with insider trading, stock manipulation, fraud, and various other violations of federal security laws. Lisa Ann Jones, a secretary at Drexel, was sent to jail for perjury for trying to protect her employers. In November 1990, Drexel pled guilty to six separate felonies and was fined \$650 million. In April 1990, Milken also pled guilty to six felonies and agreed to pay a \$600 million fine. In November of the following year, Milken was sentenced to 10 years in prison but was released after two years.

Drexel was severely criticized for paying out over \$250 million in employee bonuses in the two months before the collapse of the company. Leon Black, the head of mergers and acquisitions at Drexel, received the highest bonus at \$16.6 million, while 50 other Drexel employees received from \$1 to \$3 million dollars in bonuses. The bonuses, which were not illegal, amounted to more than double the amount on which Drexel defaulted. In 1990, Drexel declared bankruptcy. After Drexel emerged from Chapter 11 bankruptcy proceedings, its remaining assets were taken over by New Street Capital Corporation, a new company indirectly owed by Drexel's creditors.

The restructuring of Drexel's assets was handled chiefly by a 17-person team that was transferred as a whole from Drexel to Smith Barney and was headed by former Drexel employees James Schneider and David Ying. The federal government was severely criticized for its part in the cleanup when the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation ignored 1,465 lawyers retained by the government and hired the New York firm of Cravath, Swaine, and Moore to go after Drexel Burnham Lambert, in an effort to recover as many assets as possible in the suit against the troubled company.

While some of Drexel's star employees escaped prison, many of them were forced to change career directions. Fred Joseph, Drexel's chief executive officer (CEO), was banned from serving as a Wall Street CEO for life and was prohibited from taking a supervisory role in any New York Stock Exchange company for three years. During that period, Joseph served as a consultant in the dismantling of Drexel.

In 2003, Joseph made a comeback by forming Morgan, Joseph, and Company with the great-grandson of financial legend J. P. Morgan. Despite being banned from the securities industry for life, Levine set up an investment advisory business after being released from prison. Milken became one of three owners of the highly profitable Knowledge Universe, raised money for cancer research, and lectured on college campuses.

#### SEE ALSO

insider trading; stock fraud; bond fraud; Milken, Michael; Boesky, Ivan; Securities and Exchange Commission.

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## drug trafficking

DRUG TRAFFICKING is an immensely profitable enterprise that involves white-collar crime, particularly money laundering and political corruption. It is defined as the movement of illegal drugs across borders. Major drug syndicates that now look very much like other multinational firms in terms of size, resources, and sophistication conduct this transportation system. While these drug criminals have become more sophisticated, law enforcers have been slow to adapt to changing patterns of white-collar crime.

The issue of illegal traffic in drugs is an old one. In the past, drug cartels relied upon brutality. Drug traffickers, such as the infamous Colombian Juan Pablo Escobar, were noted for torturing and murdering anyone who got in their way. Such tactics deeply antagonized other individuals, often to the

point of creating a multi-person vendetta, and placed pressure upon governments to crack down on the drug traffickers. Brutality, in short, was bad for business. Today's drug traffickers, such as the Cali cartel, only use violence if other solutions are not available. These entrepreneurs prefer to work quietly. Instead of intimidating others with violent crime, they practice the more profitable white-collar crime to ensure that business runs smoothly.

The success of a drug cartel rests upon its ability to launder money. Virtually all payments for drugs are made in cash and this cash must be laundered. Money-laundering, the process of concealing ill-gotten gains to make the money appear legitimate, and thereby evade detection and prosecution, has therefore become one of the major concerns of drug traffickers.

Governments have had increasing difficulty controlling aspects of the drug trade in part because of political disputes and historic patterns of crime. For example, while both the American and Mexican governments constantly state that they want to eliminate drug trafficking and sales, they are often in disaccord about how to stop these practices. Many Mexicans identify the root cause of the drug problem as unbridled consumption by American consumers while many Americans place emphasis on improved crime fighting tactics and abilities. The connection between Mexican officials (civilian politicians, local military commanders, and police officers) and illicit drug trafficking dates back to the 1920s, and it is therefore difficult to root out. Patterns of corrupt behavior have become firmly established within regulatory agencies.

The inability or refusal of governments to cooperate against drug traffickers has occasionally led to diplomatic crises. In 1998, the U.S. government obtained indictments against the employees of a dozen leading Mexican banks accused of laundering more than \$100 million in illegal drug money. The bankers were ensnared through Operation Casablanca, a three-year undercover sting operation run by the U.S. Customs Service. The operation lured drug traffickers and their bankers to a party in a small Nevada town that was to culminate in a visit to a local brothel.

It ended, instead, in a mass arrest as U.S. law enforcement agents moved in and spoiled the party. Some 160 arrests were subsequently made during which Mexican law enforcement and banking authorities were kept in the dark about the operation

for "security reasons" to protect against possible leaks. Mexicans were outraged by the violation of their national sovereignty and the Mexican government threatened to prosecute U.S. Customs agents and their informants since sting operations like Casablanca were illegal under Mexican law. Mexico eventually declined to prosecute.

The Casablanca episode resulted in part because of Mexican laws that prevented an investigation of money-laundering in the case of individuals who have not had a prior conviction for illegal enrichment or related offenses. Since most drug lords have successfully evaded such convictions, they are exempt from investigation. Additionally, in Mexico, money-laundering is a tax violation and not a criminal offense. Consequently, the country does not have same requirements for reporting money transactions that the U.S. has put into effect. This discrepancy has allowed drug cartels to use Mexico's official banking system and mostly unregulated dollar-exchange houses to launder cash. By mid-1999, Mexico had become a major center for the laundering of drug money with ostensibly legitimate businesses on both sides of the border.

## INTERNATIONAL CRIME

The new multinational drug traffickers are not always new businesses. The massive worldwide appetite for drugs has given rise to an international criminal network of unprecedented scope and sophistication. Long-established criminal organizations have formed alliances to profit from drug trafficking. The Hong Kong-based Triads have joined with the Japanese Yakuza to market synthetic drugs on a global scale. According to Colombia's National Police, the country's powerful drug cartels are cooperating with the Russian mafia and Eastern European crime groups. Marketing worldwide brings an obligation to launder money and corrupt officials on a global scale as well.

Crumbling state control in the countries of the former Soviet Union was an open invitation to organized crime. Drug traffickers were quick to reap profits from struggling democracies, and other countries with shaky or non-existent laws, ill-equipped police forces and uncertain market forces. Additionally, the sudden shift from communism to capitalism has fostered the organization of numerous front companies that allowed drug traffickers to hide money within legitimate enterprises. The Russ-



ian Interior Ministry estimated in the late 1990s that about 40,000 Russian businesses are controlled by organized crime. Among these are law firms, banks and other businesses that can launder money for drug traffickers.

A similar situation exists within China where the profit motive and market economy have become increasingly important. With these changes, crime and corruption have become more common. China is emerging as an important drug producing, consuming, and distribution center.

The efforts of governments to ease trade across national borders has had the effect of easing drug trafficking across borders. The European Union (EU) and the North American Free Trade Agreement (NAFTA) have weakened customs controls and other security safeguards thereby making it easy for international organized crime to move into new markets, distribute drugs, and shift money. It is no longer a significant challenge for drug traffickers to smuggle pounds of dollar bills out of the United States to a place where the money can be laundered through the international financial system.

While governments have cooperated to open up borders, they have not established uniform laws or procedures to deal with drug trafficking. Each country in the 25-member EU has its own laws for extortion, wiretaps, sharing of intelligence information, and the invasion of privacy. Interpol, an international organization based in Lyons, France, that fosters global police cooperation by sharing intelligence about cross-border criminal activities among its 181 member nations, lacks both a police force and the ability to prosecute criminals. Each member country maintains and staffs a National Central Bureau to direct Interpol intelligence while local authorities investigate and prosecute criminals according to national laws. This lack of uniformity has permitted traffickers to exploit national weaknesses. They have, most notably, taken advantage of bank secrecy laws in such financial havens as Liechtenstein and Switzerland to hide massive amounts of money.

The history of the Caribbean has helped drug traffickers. The disparate legal systems of the region are based on the legal systems of the countries that conquered the islands. These disparate legal systems

based upon Dutch, English, French, and Spanish law have made for weak implementation of laws against drug trafficking. The international community has major treaties in force against drug trafficking and money laundering, including the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances. In 1998, the United Nations General Assembly had a special session on drugs, where it adopted new strategies to reduce both the supply of and the demand for illicit drugs. Despite these attempts to impose some global order, transnational drug traffickers continue to flourish. They establish networks of informers within governmental agencies, such as they have done with the various police forces in Mexico. They foil law enforcers by hiding out in "safe" countries or changing trafficking routes from one nation to another when the trail gets hot.

Most nations have agreed that action must occur at the international level if drug trafficking is to be defeated, but little effective action has been taken. As a result, the drug trade has become the fastest growing industry, legal or illegal, in the world. Drug trafficking has become the largest and most profitable tangent of white-collar crime with the tentacles of the criminals reaching into every segment of society.

#### SEE ALSO

Central America; Africa; Arab nations; Mexico; Russia; money laundering; Bank Secrecy Act; corruption.

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# E

## E. F. Hutton

ANYONE OLD enough to remember the heyday of E. F. Hutton remembers their ad, “When E. F. Hutton speaks, people listen” in which entire city blocks fell silent to hear the pearls of financial advice spoken by in whisper by a Hutton client. Chief Executive Officer Robert M. Foman was so enamored of Hutton’s image that he built a 29-story, \$100 million headquarters in Manhattan, New York City, that some people called a memorial to corporate greed.

People stopped listening to Hutton, however, after discovering that the company had been engaged in a systematic effort to avoid paying interest on short-term bank loans through a complicated scheme of check kiting. The scheme came to light in December 1981 when Hutton gave in to the pleas of the Batavia, New York, branch of the Genesee County Bank and moved accounts for its local office from the Marine Midland Bank to the small, local bank.

Over the next several days, bank officials began noticing that Hutton deposited checks worth millions of dollars. Without waiting for credit from the Federal Reserve, the bank had also paid \$8,000,000 on checks that had been written by Hutton on the account. Amazingly, the amounts that Hutton were depositing and withdrawing added up to more than

the bank’s total assets. Internal auditors who were told to monitor the Hutton account wondered why the amounts were so large when Hutton’s local office employed only four people.

Within nine days of opening the Genesee account, Hutton had deposited \$26,427,507 in checks. The 11 checks had all been written by Hutton on its accounts at United Penn Bank in Wilkes-Barre, Pennsylvania, and American Bank and Trust Company in Reading, Pennsylvania. Hutton was inexplicably moving funds among the three banks. Within that same nine-day period, Hutton had written numerous checks on the Genesee Bank totaling \$26,432,000, resulting in an overdraft of \$4,493. After additional checks arrived at the Genesee Bank, officials checked with United Penn Bank and learned that Hutton had funds to cover one but not both of two checks written on December 8 for \$6,000,000 and \$8,000,000.

Later that day, Hutton also deposited a check written on the Reading bank for \$110,000, followed by a check for \$500,000 two days later. The Reading account did not have sufficient funds to cover either check. The Genesee Bank decided to freeze the Hutton account and returned checks for \$2,071,000 and \$8,000,000, notifying the local Hutton office of their action.

During a visit to the local Hutton office, three Genesee officials told Hutton to take their business

elsewhere. The bank subsequently returned three checks totaling \$7,000,000.

Following company procedures, Genesee officials notified the auditor of their parent company about the problems with the Hutton account. Officials there reported Hutton's activities to the deputy supervisor of New York banks and sent copies to the Federal Reserve and the Federal Deposit Insurance Corporation. New York State investigators discovered that Hutton's paper trail led to Manufacturers Hanover Trust (Manny Hanny) and Chemical Bank at which Hutton's main accounts were lodged. By auditing four days of Hutton activities at the two banks, state regulators found the same pattern of inexplicable transfers of funds between Hutton offices and the two banks. For instance, audits of the Manny Hanny accounts uncovered an overnight overdraft of \$1.3 billion on the Hutton account. Both banks were astounded to learn that Hutton had been using overdrafts as short-term, no-interest loans that cheated the banks out of millions of dollars in interest. To do this, Hutton had used a check-kiting scheme, which was variously known as "chaining" or "floating" to amass huge profits at the expense of banks that handled their accounts.

Federal investigators pursued Hutton tirelessly, deciding to use Hutton to bring an end to the practice of overdrafting by big corporations. Finally, prosecutors concluded that the evidence gathered from Hutton's activities at the Northern Central Bank in Williamsport, Pennsylvania, where Hutton had been overdrawing its account for \$900,000 a day during most of 1981, provided evidence that was clear enough for a jury to understand Hutton's "illegal, fraudulent, and criminal" actions. Surprisingly, no individuals within E. F. Hutton had been targeted by investigators.

Letters dated April 20, 1984, were sent to E. F. Hutton Group, E. F. Hutton and Company, and various Hutton officials informing them of the Department of Justice's intent to prosecute E. F. Hutton. Lawyers predictably advised Hutton officials to claim the Fifth Amendment. In February, federal prosecutors found their "smoking gun" in a memo dated April 1982 written by one Hutton official to another describing the check-kiting scheme in detail.

In 1985, E. F. Hutton pleaded guilty to 2,000 counts of mail and wire fraud and was required to pay a \$200,000,000 fine in addition to repaying

banks for all money lost, plus interest. Convinced that his company had done nothing wrong, Foman paid former Attorney General Griffin Bell \$3,000,000 in fees and expenses to investigate the activities of his employees. The move backfired, and the House of Representatives opened hearings on the Hutton fiasco.

On November 8, 1986, Robert P. Rittreiser succeeded in forcing Foman to step down and took over as Hutton's chief executive officer. After taking charge of E. F. Hutton, Rittreiser set a massive reorganization plan in place. He divided Hutton into two parts: one to handle retail brokerage services and the other to oversee institutional and capital markets. Unfortunately for Hutton, on October 19, 1987, the stock market plummeted 508 points in a single day. As a hypothetical exercise, Cable News Network (CNN) explored the influence of an insolvent brokerage house on investors.

E. F. Hutton was described as a "weak link in the financial chain," and Hutton executives recognized that reclassification from its A-2 commercial rating to A-3, the lowest possible rating, was imminent. Stock shares in the company dropped \$11, and it was rumored that E. F. Hutton was in danger of going under and that Foman had committed suicide. Standard and Poor's let it be known that Hutton's credit rating was under close scrutiny. In an effort to recoup, the company had spent employee retirement funds with no ability to replace the funds' capital.

The best course of action seemed to be to sell E. F. Hutton. Foman liked the idea of revenge on Rittreiser and was also attracted to the prospect of a \$3,000,000 investment-banking fee for his role in the sale. After 83 years of providing successful advice, Hutton was up for grabs. The front leaders in the bidding war were Merrill Lynch, Dean Witter, and Shearson Lehman. After Shearson's bid of \$960 million, \$29.25 per share, was accepted on January 29, 1988, 1,450 Hutton employees were dismissed, and armed security guards searched them as they left the building. Over the next month, an additional 3,350 Hutton workers received pink slips. Ironically, Hutton had rejected a Shearson offer of \$50 a share in 1987. After the buyout, no one was listening to E. F. Hutton; it no longer existed.

#### SEE ALSO

check kiting; investment fraud; bank fraud; accounting fraud.

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## Eastern Europe

THE RISE OF white-collar and organized crime in the Eastern European (EE) nations closely parallels that of their powerful neighbor, Russia. Eastern Europe generally refers to the states formerly under the control of, or heavily influenced by the Soviet Union: Albania, Bulgaria, Czech Republic (Czechoslovakia), Hungary, Poland, Romania, and former Yugoslavia.

Once the state socialist economies collapsed in the late 1980s and early 1990s, massive economic crisis and sociopolitical dislocation created a power vacuum which has been largely filled by organized criminal elements. The economic crisis spawned by civil war and international military intervention in the Balkans also opened up opportunities for local mafias. As in Russia, neo-liberal policies, socioeconomic disparity and weak legal and democratic structures have fostered the integration of "legitimate" and "illegitimate" business. While the extent of the economic crisis in most of the EE nations has not been as severe as in Russia, all countries have registered a growing influence by organized crime in diverse economic sectors, and much of this crime is transnational with groups from various countries, especially Russia, intimately involved in numerous countries of the European continent.

The bureaucratic command economies of the EE regimes were highly centralized: production and distribution of goods were organized by state-controlled companies. As in Russia, increasing integration with the world market and growing problems in effectively coordinating the highly bureaucratic economy led, by the 1970s, to the development of a thriving black market, especially for consumer

goods and foreign currency. In all the EE nations, there was misappropriation and outright theft of state property and speculation in scarce goods. Criminal networks, including officials from state institutions, gradually consolidated through the late 1970s and 1980s. Beginning as small-scale suppliers of clothing, household articles, and building materials, some groups branched out into the bootlegging of alcohol and drug trafficking.

After the fall of the Berlin Wall in 1989 and the rapid disintegration of the bureaucratic command economies, the openings for organized crime multiplied. Socioeconomic marginalization increased dramatically, providing a fresh recruiting ground for criminal organization as well as a sharp reduction in the population's trust in legal private enterprise and government structures. Liberalization and privatization programs were corruptly managed, giving white-collar criminals in organized crime new economic activities to exploit.

As Michel Chossudovsky writes, the privatization programs in all the EE nations "favored the transfer of a significant portion of state property to organized crime." As traditional state economic structures were weakened, so too was law enforcement. Gradually, according to Ben Fowkes, organized crime brought "a culture of bribery, theft and even violence from the underground economy into the world of legal private enterprise."

The emphasis by governments on property rights and market freedom occurred at the expense of public accountability, sociopolitical equality, and economic security. While there has been economic recovery in some countries, the lion's share of the wealth has been concentrated in the hands of a tiny minority of politicians and business people, most of whom have connections with organized crime.

### BULGARIA

In Bulgaria, the privatization process offered windfall opportunities for ex-politicians such as Andrei Lukanov, twice former premier of the government and leading member of the post-communist party. Lukanov and his associates took up key positions in the newly privatized banks and industries and eventually formed a powerful financial-industrial conglomerate, Multigroup.

The directors of many of the companies in this group allegedly had access to communist party funds through banks accounts in Switzerland and



*Members of the House of Parliament in Budapest, Hungary, have been unable to stem the rise of white-collar crime, as privatization of the Hungarian state companies has delivered quick and handsome profits.*

Austria. It was suspected of pilfering state assets through hidden privatization schemes and other illegal practices. For instance, Multigroup's Intersteel used Lukanov's connections with newly privatized Russian gas companies to make huge profits from managing the old state steel company, which is one of the largest consumers of Russian gas in the country. Lukanov was assassinated in 1996 allegedly by rival organized crime interests. The illegal growth of Multigroup was replicated by diverse groups in all economic sectors so that by 2000, over half of Bulgaria's private companies were controlled by mafia interests.

## HUNGARY

In Hungary, liberalizing measures were first introduced in the 1970s: there was a steady increase in travel between EE countries and the gradual development of small-scale private industry and cross-border retail. In this way, the country became a transit corridor for Yugoslavian and Albanian arms smugglers and the location of stolen goods networks operated by Polish syndicates. Local criminal elements made common cause with these foreign groups, which soon included gangs from the Soviet republics, facilitating the growth and extension of criminal networks in and through Hungary.

Continued expansion of the private sector led to growing concentrations of private capital which became targets for organized crime. According to the former chief of the Investigation Department of the National Police in Hungary, these gangs would plant spies in high society to target potential victims and use separate gangs to execute burglaries. Still another group would be responsible for fencing or selling the stolen goods. Simultaneously, the semi-privatization process of certain areas of the economy such as catering, tourist, and entertainment allowed these gangs to launder their money and invest in "legitimate" businesses.

After the communist state collapsed, Hungarian mafias expanded their operations. By 1994, 30 percent of the gross domestic product was produced through the expansion of the black market economy of the pre-Soviet days. With rising unemployment, skyrocketing inflation and a drastic decline in economic output, crime gangs moved into all areas of the economy to provide goods and services unavailable in the legitimate economy. Privatization of the state companies also promised quick and handsome profits. The state oil monopoly was abolished in the 1990s before legal regulations were enacted to govern the new private market. Organized crime quickly took advantage of this legal vacuum, creating oil companies and using old state facilities at no

cost to dominate the market. A two-tier pricing system designed to shield ordinary citizens from price gouging also resulted in new black market opportunities for the local mafia.

The extraordinarily lucrative profits to be gained from the oil business alone has led to fierce competition and mounting violence, including numerous gangland-style executions. Since 1991, there have been more than 100 bombings and grenade explosions in Hungary as rival elements fight it out for influence and wealth.

### BALKAN PENINSULA

The countries of the Balkan peninsula have also seen a dramatic increase in organized and white-collar crime. The civil wars of the 1990s and continued political instability in the former Yugoslavia have fostered the development of conventional organized criminal activities such as consumer goods smuggling, drug trafficking, prostitution and auto theft. Albanian gangs have used their connections with growers in Afghanistan and an increasingly sophisticated use of the internet to corner the heroin market in much of Europe. When sanctions were

imposed on Serbia in 1992, land and water routes were strictly controlled within Yugoslavia, allowing the emergence of widespread black market networks of fuel, food, and other goods which circumvented the embargo through cross-border trade from Bulgaria and Romania. It is also apparent that much of the billions in aid to countries such as Bosnia—either in the form of money, food, or medicine—has been stolen by local mafias in alliance with corrupt politicians.

### POLAND

In Poland, the story is similar. The more than 400 organized criminal factions are involved in everything from drug trafficking and prostitution to protection rackets and smuggling. The U.S. State Department claimed in 2001 that Poland had become a major center for the production of synthetic drugs such as Ecstasy and amphetamines, as well as a trans-shipment point for suppliers of narcotics in Turkey and the Ukraine. Drug addiction and drug-related crime have soared in the last decade. The drug business is apparently controlled by three major syndicates operating out of Gdansk



*Gray smoke rises above the rooftops of Warsaw, Poland, symbolizing the rise of industrial capitalism and its side effects of pollution, and growing organized and white-collar crime.*

and Warsaw. The Pruszkow mafia is one of the largest of such groups. It engages in car and art theft, money laundering, extortion, prostitution and drug trafficking. It has been involved in a bloody turf battle with the Wolomin group for control of these lucrative economic activities.

As in Russia and other Eastern European countries, the importing and exporting of women for sexual exploitation is flourishing in Poland. Police estimate that 15,000 young women from Bulgaria, Romania, and the former Soviet republics are brought into Poland for prostitution each year. Recent reports suggest that criminal groupings from other EE nations and the former Soviet republics have made attempts to take over this trade, resulting in public gun battles and numerous murders.

#### CZECH REPUBLIC (CZECHOSLOVAKIA)

In Czechoslovakia (split as the Czech Republic and Slovakia in 1993), organized criminal gangs were first founded by immigrants from the large Vietnamese community. By 2003, there were 10-15 such organizations involved in smuggling goods such as cigarettes and people from Central Asia and Southeast Asia to Western Europe, including sex trade workers. Vietnamese gangs engage in money laundering, drugs, and extortion and invest in legitimate business such as restaurants and casinos. In recent years, authorities report that native Czechs are now working for these criminal elements who inextricably merge traditional organized crime with legitimate business.

By the mid-1990s, the Czech Republic also received an influx of organized criminal gangs from Russia, the Ukraine, and Chechnya. Beginning with illegal immigration schemes for Russian and Ukrainian workers, these international groups expanded into drug trafficking and prostitution. Transnational gangs such as these have introduced the highly profitable trade of arms smuggling into Czechoslovakia in the early 2000s. Arms smugglers use the country to sell to rogue regimes seeking clandestine deals that will not be noticed by international authorities. In 2002, two Czechs and a Canadian were arrested for allegedly selling small arms to Iraq.

During home searches, catalogues of Russian-made weapons were found which were being offered to customers in Arab countries. In addition to firearms, the catalogues also offered tanks, missile

carriers, boats, and planes. In 1999, a Czech company was discovered trying to sell six fighter jets to North Korea. Weapons trading is officially legal in the country, but government spokespeople admit that they have little control over the companies or the thousands of transactions that occur each year.

#### ALBANIA

The Albanian economy enjoyed an economic boom in the early 2000s. Yet, observers such as the respected non-governmental organization, International Crisis Group (ICG), note that just under half of the gross national product results from organized crime. As in the other EE countries and Russia, the distinction between corporate crime and organized crime is blurry, especially since organized crime runs, or heavily influences corporate behavior, whether legal or not. As Kreshnik Spahiu, a lawyer involved in anti-drug trafficking cases, laments, "The reality is that Albania is built with black money." In the early 1990s, the first phase of the post-communist transitional economy was financed through pyramid schemes which collapsed in 1997, bringing with them widespread chaos. According to the ICG, a wide layer of politicians, government bureaucrats, police and respectable businesses are all implicated in organized crime.

#### ROMANIA

Romania does not grab as many of the headlines as the other European countries, yet its population of 22 million makes it one of the biggest countries in Eastern Europe. It shares all the major features of organized crime in the neighboring nations: close ties to politicians and respectable firms, shady dealings with formerly state-owned property, and involvement in smuggling, prostitution, and extortion schemes.

The early 1990s saw a massive banking fraud perpetrated by former state officials which led to the loss of the life savings of tens of thousands of small-scale investors. Romania's current economic woes stem from massive under-development during the communist era. Once again, mafia elements have moved in to take advantage of a poorly functioning system of consumer goods production and distribution. The country's proximity to Russia has also facilitated the growth of drug trafficking, illegal immigrant smuggling, automobile theft, and, per-

haps most seriously, a black market in nuclear material from the former Soviet republics. Romania's organized crime comprises tightly knit crime families with close connections to politicians, like-minded mafias in the other EE countries, and legal private enterprises.

While there have been attempts by lawmakers and the police, often in alliance with international agencies and governments, to combat organized crime in Eastern Europe, most observers report that it is a losing battle. Some nongovernmental organizations, trade unions, and other groups in civil society have begun to courageously publicize and organize against corruption, but these initiatives have so far only made a minor impact.

#### SEE ALSO

corruption; Russia; human trafficking; drug trafficking; organized crime.

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## economic espionage

ACCORDING TO THE Federal Bureau of Investigation (FBI), economic espionage refers to the stealing of trade secrets or confidential information by foreign governments or companies against U.S. businesses. Trade secrets are any secretive, private,

or proprietary intellectual property including formulas, patents, budget and marketing plans, customer lists, new technology developments, pricing information, or any other type of information that has some potential economic value. These secrets typically account for roughly 70 percent of a company's market value, making them a highly valuable asset and a prime target of many competitors.

The premium placed on such information represents a fundamental shift from an economy based on tangible goods to a system based on intellectual property. Illegally obtaining access to a trade secret gives foreign competitors several advantages. It gives foreign entities the opportunity to introduce the product or service before anyone else, and thus realize a larger profit. In addition, the stealing of trade secrets allows an entity to under-price the original owner or developers since less money is needed for research and development. Finally, economic espionage allows a company to modify and/or improve upon the stolen trade secrets.

Several companies consider economic espionage a more cost efficient means of spending resources. Rather than spend the time and money to conduct actual research and development, companies can spend a fraction of the cost to steal information.

In one of the largest economic espionage cases to date, Avery Dennison spent roughly \$200 million on research and development over a four-year span to develop adhesive formulas and tapes. One of its foreign competitors Four Pillars, a Taiwan-based company, paid an Avery Dennison employee, Victor Lee, only \$160,000 over eight years to steal proprietary information concerning the development of adhesive formulas. In all, Lee stole approximately 12,000 research and development documents including 71 adhesive formulas and 37 trade secrets concerning specialized adhesive tapes.

Estimates indicate that economic espionage costs U.S. companies tens of billions of dollars each year in lost trade secrets and other proprietary information. According to the American Society for Industrial Security (ASIS) and federal government estimates, U.S. businesses lost approximately \$1.2 trillion during the 1980s to economic espionage. More recently, a 1999 ASIS survey indicated that 97 of the top 1000 Fortune companies lost over \$45 billion in stolen trade secrets. Approximately half (44) of the companies had more than 1,000 incidents of theft totaling nearly \$1 billion. The aver-



age estimated loss was approximately \$500,000 per incident.

According to the survey, most acts of economic espionage occurred in high technology and service industries, while the manufacturing industry tended to lose the most money, averaging a loss of almost \$50 million dollars per incident. Small and medium-sized businesses generally suffered the most significant losses. Many of these companies were unable to recover from the loss of trade secrets which are extremely vital for survival.

## NATIONAL SECURITY

The tremendous scope and huge financial losses attributed to economic espionage led former FBI Director Louis Freeh to assert that foreign countries stealing and spying on U.S. companies represents the most serious threat to the nation's security since the Cold War era (aside from terrorism). In this respect, economic espionage has been viewed as a threat to the long-term survival of many U.S. companies.

Traditionally the term *espionage* was associated with military spying and the stealing of military information or secrets. With the end of the Cold War, a new form of espionage emerged that concentrated more on the spying and stealing of confidential economic and intellectual properties. At the same time, the United States emerged as a dominant economic power. Subsequently, America became one of the leading nations in developing valuable intellectual property and contributing new services and products to the world market. As a result, foreign companies and governments began to establish spy networks to target and obtain U.S. companies' trade secrets in order to remain competitive. During the 1990s, FBI information revealed that at least 23 countries had engaged in acts of economic espionage against U.S. companies.

Another FBI finding indicated that at least 100 foreign governments and/or businesses were spending resources to target and acquire U.S. technology. Over half of these companies were using covert operations. The most frequently targeted industries include aerospace, computer hardware and software, defense technology, and biotechnology. Because of the increased development and reliance on computers, most companies have become especially vulnerable to hacking. In 1994, a group of hackers from St. Petersburg, Russia, stole over \$10 million from

Citibank. The group hacked into the company's computers and transferred money into banks in seven different countries. Computers have allowed companies to store more information in a single location, but at the same time this information has become more accessible and easier to steal. Through the use of a computer, a single individual can copy, download, and transfer confidential information within minutes to other parts of the world. In addition, computers provide a great deal of anonymity making it difficult to apprehend offenders. Lastly, the use of computers to engage in economic espionage makes investigation and detection a fairly complex and difficult task. In many ways, computers have inadvertently become a tool in the realm of economic espionage.

## ECONOMIC ESPIONAGE ACT

In order to address the growing concerns of U.S. companies and their vulnerability to economic espionage, Congress enacted the Economic Espionage Act (EEA) of 1996 to effectively criminalize the stealing of trade secrets. Under the EEA, trade secrets are broadly defined to include "all forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing." The EEA also stipulates that the owners must take "reasonable measures" to keep confidential information a secret. If owners fail to safeguard proprietary information, no one can be rightfully accused of stealing it. Finally, the act requires that the trade secrets must have some form of actual or potential economic value.

The EEA is a combination of sections 1831 through 1839 of the U.S. Codes. The Foreign Trade Secret Theft or section 1831 of the EEA specifically addresses the issue of economic or foreign espionage. In many respects, problems and concerns with foreign invasions were the single most important reason why the EEA was passed. Under section 1831, criminal penalties will occur when an accused steals without authorization a trade secret that will knowingly or purposefully benefit any foreign government and agency.

This includes the stealing by any foreign government or agent or anyone acting on their behalf. Criminal penalties for violating this section of the EEA include a fine of up to \$500,000 or imprisonment up to 15 years, or both for an individual and for an organization, a fine of up to \$10 million. Also under the EEA, a court can force a person to forfeit to the United States any property or proceeds obtained directly or indirectly from a violation of the EEA.

## PROSECUTION

Prosecutions under the EEA have been relatively rare. As of 2003, only 37 cases have been successfully prosecuted under the act. One of the primary problems is the reluctance of companies to file criminal charges. Most companies fear the risk of publicly disclosing valuable trade secret information through court documents. In an espionage case involving Bristol-Meyers Squibb and their secret formulas for the cancer-fighting drug, Taxol, federal judges ruled that prosecutors had to release the confidential documents to the defendants' lawyers in order to protect due process rights. The defendants' were Yuen Foong Paper Co., a Taiwanese company that had two employees.

They approached an FBI agent, posing as a Bristol-Meyers technology information broker, and allegedly offered him \$200,000 plus a percentage of their sales for access to Taxol technology. Bristol-Meyers appealed the ruling in an effort to protect the secrets from those accused of attempting to steal them. In this way, the EEA presents problems for both victims and the accused. Many companies have turned to private consulting or intelligence agencies to help prevent future incidents of economic espionage.

## SEE ALSO

industrial espionage; corruption; bribery; computer hacking.

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## Edelhertz, Herbert (1922–1999)

HERBERT EDELHERTZ WAS a criminologist and scientist who specialized in the study of white-collar crime and organized-crime business activities. He authored several books and reports on the business of organized crime, corporate fraud, and the prosecution of white-collar crime. Edelhertz defined white-collar crime as any "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 advantages." This explanation, though it attempts to improve upon Edwin H. Sutherland's original working definition of white-collar crime, has been criticized for its overbroad approach that leaves room for the inclusion of non-occupational crimes.

Edelhertz, however, claimed that Sutherland's definition ("a crime committed by a person of respectability and high social status in the course of his occupation") was too restrictive. He believed that white-collar crimes encompassed non-business activities such as filing false personal income tax returns, claiming fraudulent social security benefits, and concealing assets in a personal bankruptcy.

In his essay for the book *White Collar Crime: An Agenda for Research*, Edelhertz stressed the importance of distinguishing between "the different forms of behavior that fall under the rubric of white-collar crime, since they may vary so widely in terms of motivation, characteristics or *modus operandi*, victims, impact, and amenability to remedies." He also recommended better data availability on the incidence and impact of white-collar crime. Edelhertz described how solving the problem of white-collar crime must include a focus on the issues of equity and sentencing. The disparity between the infrequency with which criminal charges

are brought against white-collar offenders and the regularity with which “crimes of the poor and disadvantaged” are prosecuted is a shortcoming of corporate crime policy. When Edelhertz published his report, *The Nature, Impact and Prosecution of White-Collar Crime*, the National Institute of Law Enforcement and Criminal Justice felt that white-collar crimes were receiving scant attention from the law enforcement agencies and research communities. As the economic and social environment of a region changes, Edelhertz wrote, we become more vulnerable to white-collar crime. Although street crimes, burglaries, and drug violations seem more pressing, Edelhertz asserted that “to ignore white-collar crime is to undercut the integrity of our society.”

Edelhertz was in the private practice of law before becoming a staff scientist in the Science and Government Center of the Battelle Human Affairs Research Centers in Seattle, Washington. He also directed nationwide federal prosecutions of white-collar criminal activities as chief of the Fraud Section, Criminal Division, U.S. Department of Justice.

#### SEE ALSO

Sutherland, Edwin H.; differential association; Cressey, Donald; organized crime.

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## Eisenhower, Dwight D. (1890–1969)

IN THE 1952 presidential election, both the Democratic and Republican parties courted General

Dwight Eisenhower who had led the Allied forces to victory in World War II, and who had served as commander of NATO forces from 1948 to 1951. Eisenhower was not a partisan by any means. Before 1952, he had never voted in a single election. One of Eisenhower’s most lasting legacies was the appointment of Earl Warren (1891–1974) as chief justice of the Supreme Court in 1953.

The Warren Court became one of the most liberal courts in the history of the United States, handing down major decisions that changed the fabric of life in America. For instance, *Brown v. Board of Education* 347 U.S. 483 (1954) began the move toward desegregation of public schools; *Gideon v. Wainwright* 372 U.S. 335 (1963) required states to provide lawyers for individuals who could not afford them; and *Griswold v. Connecticut* 381 U.S. 479 (1965) articulated the implied right of privacy that led to the landmark abortion decision *Roe v. Wade* 412 U.S. 962 (1973). Eisenhower later said that naming Warren to the Court was the worst decision he made as president.

### MILITARY-INDUSTRIAL COMPLEX

Perhaps Eisenhower’s greatest legacy in the field of white-collar crime was his unprecedented acknowledgement and warning to the American public about the collusion of industry and government.

In his farewell speech in 1961 prior to departing from office, Eisenhower outlined his concerns:

... This conjunction of an immense military establishment and a large arms industry is new in the American experience. The total influence, economic, political, even spiritual, is felt in every city, every State house, every office of the Federal government. We recognize the imperative need for this development. Yet we must not fail to comprehend its grave implications. Our toil, resources and livelihood are all involved; so is the very structure of our society.

In the councils of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military industrial complex. The potential for the disastrous rise of misplaced power exists and will persist.

We must never let the weight of this combination endanger our liberties or democratic processes. We should take nothing for granted.

Only an alert and knowledgeable citizenry can compel the proper meshing of the huge industrial and military machinery of defense with our peaceful methods and goals, so that security and liberty may prosper together. The prospect of domination of the nation's scholars by Federal employment, project allocations, and the power of money is ever present and is gravely to be regarded.

Eisenhower's warning could not have been more prescient. In subsequent decades, the revolving door of professionals working for government agencies and then being hired by the very same contractors whom they previously supervised, and vice versa, has grown exponentially. Government contract fraud, government procurement fraud, bribery, and collusion have become major white-collar crimes and can threaten the integrity of presidential administrations as well as companies.

In 2003, Eisenhower's concept of the collusion between government and business was illustrated once more as Vice President Dick Cheney's former company, Halliburton, scooped up numerous reconstruction contracts in post-war Iraq. Public scrutiny questioned just how much an influence Halliburton had in President George W. Bush's decision to invade Iraq.

#### SEE ALSO

military industrial complex; Bush, George W.; government contract fraud; government procurement fraud; bribery; corruption; revolving door.

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## Eli Lilly

SINCE THE 1970s, this pharmaceutical manufacturer has been hit with hundreds of lawsuits arguing that the company failed to disclose risks associated with four substances: diethylstilbestrol

(DES), a synthetic estrogen widely used to prevent miscarriages; Oraflex, an anti-inflammatory; Prozac, the popular antidepressant; and thimerosal, a preservative used in vaccines. Of the drugs that Lilly may have marketed without proper research or disclosure, DES has caused the most pervasive and best documented harms. The Centers for Disease Control and Prevention (CDC) estimate that 5 to 10 million people are at risk from side effects from DES, many of them children or grandchildren of women who were prescribed the drug.

First synthesized in 1938 by Edward Charles Dodds, DES was embraced by researchers as a less expensive, more potent substitute for natural estrogen, potentially able to cure a variety of female reproductive ailments. Colleagues recall Dodds consulting for Lilly in the 1930s, says investigative journalist Robert Meyers, but Lilly attorneys deny the researcher was ever on the payroll. Since Dodds refused to seek a patent, Lilly was only one of over 250 companies that would make or market the drug.

Dr. Don Carlos Hines recalled later, in testimony prepared for Lilly's defense, that in December 1940 he joined with representatives from three other major pharmaceutical companies to pool their research in support of Food and Drug Administration (FDA) approval for DES. Hines also insisted that results from animal testing, which showed that DES caused cancer and reproductive abnormalities, could not be generalized to humans.

In 1979, a New York jury disagreed, awarding Joyce Bichler, whose mother had been prescribed DES while pregnant, \$500,000 in civil damages. The jury found that Lilly had coordinated with other drug manufacturers to avoid doing proper testing, and that a prudent manufacturer would never have brought the product to market if testing had been done.

Bichler was one of a number of women, all exposed in the womb to DES, who in their teens or early 20s developed a rare form of vaginal cancer, clear-cell adenocarcinoma. A pattern of this disease, formerly seen only in post-menopausal women, was noticed in the late 1960s by Dr. Howard Ulfelder of Massachusetts General Hospital. Researchers later found that "DES daughters" also face higher risks for reproductive tract abnormalities, ectopic pregnancies, and infertility. Problems found in "DES sons" include genital abnormalities and a higher rate of noncancerous

cysts on the testicles. Women who took DES may face higher breast cancer risks.

Meyers notes that Lilly's salespeople were actively promoting DES to doctors and pharmacists even before it was approved by the FDA. Among the research omitted from later DES promotional brochures was a study, conducted from 1950 to 1952 at the Chicago Lying-In Hospital, that found DES not only failed to prevent miscarriages but seemed to cause them. Lilly did not fund its own research on DES effects until after the FDA banned the drug in 1971.

The company did fund research on anti-arthritis drug Oraflex, approved by the FDA in 1982. However, they did not disclose to the FDA that the drug could cause liver or kidney damage in elderly patients, despite reported fatalities in the United Kingdom and Denmark. Available for just three months in the United States, Oraflex is believed to have caused 26 deaths and 200 cases of non-fatal organ failure. In August 1985, Lilly pled guilty to 25 misdemeanor counts of withholding information and mislabeling, paying \$1,000 per count. The sole civil judgment against Lilly was secretly settled during the appeals process.

Secret settlements were also critical to Lilly's ability to fend off lawsuits related to the popular anti-depressant Prozac, explains an investigative report by the company's hometown newspaper, the *Indianapolis Star*. As well as quietly settling more than 200 suits alleging that Prozac caused violent or suicidal behavior, Lilly offered to pay the legal costs of doctors sued for prescribing the drug. "This is a public relations controversy, not a medical controversy," Lilly spokesman Edward West told the *Wall Street Journal*. The active ingredient, fluoxetine hydrochloride, is no longer under patent. Lilly continues to market Prozac despite a 73 percent drop in U.S. sales of fluoxetine products in 2002; the drop is attributed to generic competitors.

Strangest of Lilly's product liability dramas is how protection from lawsuits related to thimerosal, a mercury-based vaccine preservative not used in the United States after 1999, found its way into the Homeland Security Act of 2002. Title 17 amends the Public Health Service Act to set a three-year time statute of limitations on civil suits for harms from any labeled component of a vaccine, not just the active ingredients.

Most cases would instead go to a special vaccines court administered by the U.S. Court of Fed-

eral Claims. Though faced with lawsuits from parents who claim that thimerosal in routine vaccinations caused their children's autism, Lilly denied lobbying for the measure. Retiring Senator Dick Armey (R-TX) claimed credit, but many pundits dismissed this as a publicity move. Considerable debate surrounds medical studies on potential links between vaccines and autism.

With the exception of vaccines, all of the company's product liability issues have centered on flagship products. Lilly claimed from 50 percent to 70 percent of the market for DES and held patents on Oraflex and Prozac. The latest marketing success to face legal challenges is Zyprexa, a schizophrenia drug that accounted for one-third of Lilly's sales in 2002. Five suits accuse Lilly of suppressing evidence that Zyprexa can trigger diabetes.

On the other hand, Lilly's corporate record is not all suspect; the company has developed numerous initiatives, including, for example, producing new and safer forms of insulin and spending millions per year on diabetes education.

#### SEE ALSO

Food and Drug Administration; pharmaceutical industry; unsafe drugs; research fraud.

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## elite crime

ELITE CRIME includes acts committed by members of the upper classes, including these who head corporate and governmental organizations. The phrase perhaps best fits Edwin H. Sutherland's definition of white-collar crime as "a crime committed by a person of respectability and high social status in the course of his occupation."

Though the cases have been made that white-collar crime encompasses more than just occupational malfeasance committed by persons of "high social status," (note, for example, crimes committed by low-level employees), crimes committed by elite members of society may have the most damaging effect. Elite crimes may be committed for personal gain and/or for fostering the power, profitability, or influence of the organization.

White-collar crime is massively harmful financially, but also includes violence and reduction of civil liberties. 2002's big crime story was a long and complicated saga of corporate financial shenanigans that caused a significant drop in stock market prices. Although the economic losses were widespread, *Fortune* magazine notes: "The not-so-secret dirty secret of the crash is that even as investors were losing 70 percent, 90 percent, even in some cases all of their holdings, top officials of many of the companies that have crashed the hardest were getting immensely, extraordinarily, obscenely wealthy."

At center stage was Enron Corporation, a multibillion-dollar energy-rights trading company, which declared one of the largest bankruptcies in history on December 2, 2001, with debts of over \$31 billion. Enron was subsequently accused of having perpetrated a massive "disinformation" campaign, hiding the degree of its indebtedness from investors by treating loans as revenue, and hiding company losses by creating new firms with company capital, and then attributing losses to them rather than Enron. As Enron shares were taking a dive, Chief Executive Officer Ken Lay was e-mailing concerned employees, advising them to hold their shares and buy new ones.

Meanwhile, Lay cashed in \$103 million of his own shares in the company. Enron executives unloaded nearly a billion dollars worth of stock while employees were locked out of selling the holdings in their pensions during much of the period in

which the company's stock fell from \$80 a share to \$0.30. Enron investors collectively lost about \$60 billion, which included many large pension plans and the retirement savings of up to 20,000 Enron employees.

Enron turned out not be an isolated incident and the list of companies touched by financial scandal soon included Tyco, Global Crossing, Quest, WorldCom, Xerox, Adelphia, MicroStrategy, ImClone, and homemaker Martha Stewart, AOL-Time Warner, K-Mart, and some major banks, such as Citigroup and J.P. Morgan Chase.

In terms of violence committed by the elite, environmental pollution, unsafe working conditions, and unsafe products have all produced scores of deaths and injuries. Thousand of workers die each year due to the acts of their employers, but rarely is their criminal liability. The felony is an exception. In September 1991, a fire destroyed a chicken-processing plant in Hamlet, North Carolina. When the 100 employees in the plant tried to escape, they found that the company executives had ordered the doors locked "to keep out insects and to keep employees from going outside for coffee breaks, or stealing chickens." Twenty-five workers died in the fire; some were found burned to death at the doors they couldn't open. Another 50 were injured.

The owners of the company and two plant managers were charged with involuntary manslaughter. The outcome: The owner pleaded guilty and was sentenced to 10 years and 6 months in prison. Some people may not think this is a severe enough punishment for someone responsible for 25 very painful deaths, but note three revealing facts. First, the sentence was "believed to be the hardest judgment over handed out for a workplace safety violations." Second, as part of the plea agreement, the involuntary manslaughter cases against the two plant managers were dismissed, though they surely knew that the doors were locked and what the risks were. And third, the owner eventually served a little more than four years in prison and was released. Such a person sentenced is an exception to the rule.

Elite crime is not prevalent only in the corporate world: During the 1960s and 1970s federal agencies, including the executive branch, Central Intelligence Agency, and Federal Bureau of Investigation (FBI) illegally tapped phones, and violated many civil liberties of those involved in the civil rights movement and anti-Vietnam war movement. Perhaps the most elitist position in the world, the



*The concept of elite crime: The man above is convicted of \$250 million in stock fraud, while the man at right ...*



*... is convicted of stealing a \$2,500 car from his employer. Which man will serve significant, hard time in prison?*

U.S. presidency, is not immune, either. Former President Richard M. Nixon resigned due to the white-collar, elite crimes he committed during his presidency, including Watergate. J. Edgar Hoover, head of the FBI, was a major player in promoting and overseeing such illegal activities against the civil rights movement and anti-war movement.

Elite criminals usually are not arrested, and if convicted get much more lenient sentences than working- and lower-class criminals. On July 11, 2002, at a hearing of the Crime and Drugs Subcommittee for the Senate Judiciary Committee on the subject of "Penalties for White-Collar Crimes: Are We Really Getting Tough on Crime," Senator Joseph Biden, Jr. (D-D) said:

Under federal law, if ... you steal a car out of my driveway and you drive it across the state line into Pennsylvania, ten years. Ten years, federal guideline. You take a pension by violating ERISA, the federal system to safeguard pensions, misdemeanor, and maximum one year. The pension may be worth \$1,800,000. My car may be worth \$2,000.

The simple fact is that many people believe the American criminal justice system reserves its harshest penalties for its lower-class clients and puts on kid gloves when confronted with a better class of crook.

#### SEE ALSO

corruption; bribery; prosecution; Sutherland, Edwin H.; Nixon, Richard M.; Watergate.

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## embezzlement

EMBEZZLEMENT IS A wide-ranging offense that involves the misappropriation or destruction of money or property with which a person has been entrusted. Virtually any property, including animals and trade secrets, can be embezzled. Its etymological origin has been traced to the French *embeiseller*, which means to destroy or to make away with. The offense runs a gamut from willful failure to return a rented DVD movie to a multimillion dollar theft by

an employee of a large corporation. Under most circumstances, embezzlement should be one of the simplest crimes to commit because there are very few easier ways to obtain money without working for it than retaining someone else's property, which is already in one's possession or control.

The crime we now know as embezzlement originated in England as a common law offense in 1473 based on the Carrier's Case, which involved the theft of bales of wool by an agent while transporting them to the coast. This was the first time that an agent who stole goods placed in his care could be criminally prosecuted. Prior to the Carrier's Case, no "trespass" or usurpation of the goods (the essential element of larceny at the time) could be shown in a theft-after-trust because the goods were considered to be in the legal possession of the thief.

Carrier's Case may be seen as an example of "structural Marxism"—when laws are enacted in order to promote the viability of a capitalistic economic system. If the precedent in Carrier's Case had not been created at the time that it was, the establishment of English and other European trade routes of the 15th and 16th centuries would have been severely retarded; there would be no recourse for theft-after-trust by transportation agents. Carrier's Case was absolutely necessary to promote the growth of those economies.

The first statute outlawing embezzlement was not enacted until 1529. Embezzlement statutes originally specified trust theft from specific victims (the military, banks, post office, a servant's employer), and then evolved into the modern general definition of wrongful conversion of entrusted property.

## PROBLEMS IN APPLYING LABELS

Embezzlement is a crime of specific intent in which a person purposely misappropriates, misapplies, or destroys something that has been legally entrusted to that person but which she does not own, thereby usurping the legal owner's control. Embezzlement is essentially interchangeable with the crime of criminal conversion because both are defined in terms of theft-after-trust. Criminal conversion is often an essential element of embezzlement, and some jurisdictions have only conversion statutes by which to punish embezzlers. If any difference exists between embezzlement and criminal conversion, it is that in embezzlement the thief usually holds a fiduciary relationship to the victim, such as trustee,

guardian, agent, or employee. Persons charged with embezzlement need not hold such a relationship, and persons charged with criminal conversion may indeed meet the requirements of a fiduciary.

To complicate matters further, embezzlement is usually differentiated from fraud according to the exact moment at which the intent to steal (*mens rea*) was present. If the intent existed prior to possession of the property stolen, then the offense constitutes fraud rather than embezzlement. This is also known as "bad faith" embezzlement because before the thief takes possession of the goods there is intent to steal them. "Good faith" embezzlement, on the other hand, is true embezzlement, and involves taking possession of the goods without having criminal intent to steal them, but such intent materializes sometime after possession of the goods has occurred.

Many persons have been convicted of embezzlement even though they formed the intent to steal before gaining possession of whatever was peculated. Larceny is a lesser offense compared to embezzlement, but necessarily included in it. Stealing from another's cash drawer to which one has legitimate access is embezzlement, but this scenario is often punished as larceny. Embezzlers, then, are often incorrectly charged with offenses instead of embezzlement or criminal conversion.

## WHITE-COLLAR EMBEZZLEMENT

Edwin H. Sutherland referred to embezzlement as an example of white-collar crime when he first coined the phrase in 1939. White-collar crime for Sutherland referred to crimes committed in the course of occupation by persons with high social status. He continued to equate embezzlement and white-collar crime in virtually all of his later publications on the subject.

However, embezzlement is committed in many circumstances which do not meet the criteria for a white-collar crime, either in terms of the offender's high social status or the criminal opportunity arising in the course of occupation. In the first major research work on embezzlement—*Other People's Money* (1953) by Donald Cressey—it was found that, as a group, the trust violators in the study could not be considered white-collar criminals because they lacked the requirement of high social prestige. Similarly, Dorothy Zeitz, who studied female embezzlers, did not find that the women could



be characterized as having high social status. It is significant that neither of these two major research studies on embezzlement referred to their trust violators as white-collar criminals. Technically, then, using Sutherland's original conception, embezzlement can only be considered a white-collar crime when persons commit a theft-after-trust while they are, in Sutherland's terms, wearing "good clothes at work."

Perhaps the most telling difficulty in pinpointing the relationship between embezzlement and white-collar crime is revealed in Sutherland's belief that white-collar crime is fundamentally organized crime. He believed this because legal definitions of white-collar crimes often necessitate an organized conspiracy or collusion—such as in price-fixing, bid-rigging, commercial bribery, industrial espionage, and physician fee-splitting. Further, he believed that persons working on behalf of large corporations were formally organized both in their attempts to control legislation governing their business behavior and efforts to influence the selection of regulatory administrators who enforce laws against them.

Sutherland also discussed "informal" organization of white-collar criminals, referring to business moralities that run counter to the law. Entire industries or professions—or major segments of them—are often characterized by beliefs that favor the violation of legal norms, thereby tacitly encouraging the commission of white-collar crime. Some white-collar criminals who violate the law are not chastised by their counterparts and peers because so many engage in the same or similar illegalities—thus, they are "informally" organized around legal violations.

The vast majority of embezzlements, on the contrary, are unlike other "organized" white-collar offenses because they lack criminal organization. First, the legal definition of embezzlement does not require collusion. Second, occupational embezzlers as a group are not formally organized to avoid criminal labels for the behavior.

Third, embezzlement lacks "informal" organization, for it can hardly be said that the crime is promoted by widespread business beliefs that encourage it. If anything, embezzlement is most associated not with organized offenders but with organized white-collar victims.

To illustrate, Sutherland referred to embezzlers as the most foolish of all white-collar criminals be-

cause they are relatively powerless compared to their victims. Relatively little embezzlement, then, is white-collar crime according to the original conceptualization of the term because it has nothing to do with Sutherland's three criteria (criminal organization, high social status, occupational opportunity). Anyone with entrusted property or ideas of any kind can commit embezzlement.

Although they represent a very small proportion of all embezzlements, there are some instances where Sutherland's three conditions for white-collar crime have been met. As an example, Henry Pontell and Kitty Calavita describe collusive frauds involving savings and loan financial institutions during the 1980s that led to "collective embezzlement." These offenses were very organized and always collusive, involving an inside officer or employee who violated trust by knowingly approving illegal loans, deriving financial benefit. Whereas typical corporate crime involves the use of the organization's resources to commit crimes against consumers and other organizations, Pontell and Calavita point out that collective embezzlers use the organization to commit crimes for their benefit.

#### AGGREGATED EMBEZZLEMENT DATA

The primary source on the extent and characteristics of embezzlers in the United States is the Uniform Crime Reports (UCR), compiled annually by the Federal Bureau of Investigation from data submitted by state and local police departments. The UCR does not record embezzlement offenses. However, embezzlement is classified as a Type II, or "non-index," category in the UCR, which means it is reported only in terms of the number of persons arrested for embezzlement, and their basic demographics (race, sex, and age). The annual number of arrestees for embezzlement is far less than the numbers for most other offenses.

The UCR definition of embezzlers includes those involved in any "misappropriation or misapplication of money or property entrusted to one's care, custody, or control." As such, the UCR category contains embezzlers and criminal converters, regardless of their social prestige or whether their crimes occurred in the course of their legitimate employment. It would also include trust violators without regard to whether the offender first took possession of the stolen property in good faith. Because this category for embezzlers includes all types

of trust violators, it is inappropriate for scholars to represent it as indicating any involvement in white-collar crime, whether in numbers of arrestees or in terms of involvement by race, sex, and age.

## EXPLANATIONS OF EMBEZZLEMENT

The platitudinous (and sexist) “cause” of embezzlement has been variously termed “wine, women, and wagering,” “bookies, babes, and booze,” and “slow horses and fast women.” These are, of course, motives for stealing rather than explanations for it. Cressey has noted that when people tell you “why” they embezzled—that is, their motives—they do not explain why they embezzled. In searching for a fresh approach through the use of “analytic induction,” Cressey revamped hypotheses until he reached a four-step process that he believed explained the crimes of all 133 federal embezzlers he studied in his classic work *Other People's Money*: 1) there exists an nonsharable financial problem, a problem that the offender is ashamed or afraid to share with others and for which legitimate sources of money are unavailable; 2) embezzlement is seen as a means for solving the problem; 3) the offender possesses the technical knowledge to carry out the theft; and 4) the criminal behavior is neutralized to be acceptable or to reflect general nonresponsibility of the offender. For example, the money was “borrowed” rather than stolen, the victim mistreated the offender and deserved to be victimized, the money belonged to the offender anyway, or the offender had personal issues.

There are at least two problems with Cressey's methodology. First, it is based upon incarcerated offenders who are several stages removed from the offense itself—not all embezzlers are discovered, arrested, charged, convicted, or given a disposition of imprisonment, and attrition will occur at each of these stages. His group, then, cannot be claimed to be representative of good faith occupational embezzlers. Second, after arriving at his analytically induced four-step process—rather than using the more straightforward method of strict hypothesis testing—Cressey may well have forced his interpretations to fit his theme.

Cressey has essentially agreed with this latter criticism when he stated in *Other People's Money* that there is no positive answer to the question of whether he neglected or unwittingly distorted negative cases. Later researchers have come across many

instances in which Cressey's motive of the non-sharable financial problem was not a universal precondition to the offense. For men, a taste for a more affluent lifestyle—that is, greed—also proved to be a major motivator to embezzlement. For women, stealing was seen as a way of meeting the basic needs of their families or of retaining or regaining the affectations of a mate. Each of these motives was perceived by the actor to be a financial need, but they were not necessarily pressing monetary problems.

Thirty years after his original research, Cressey concluded that although the non-sharable financial problem was not critical, the neutralization of the criminal nature of the behavior was his most salient finding. However, many of the embezzlers in others' research freely admitted that they knew that embezzlement was wrong before they committed it and they did not feel any need to neutralize. Women embezzlers have stated that there was no need to neutralize because they were simply fulfilling expectations ingrained since childhood that mandated they take care of their families and mates.

Two other theories, differential association and self-control, deserve mention because, unlike Cressey's attempt to explain embezzlement specifically, these theories purport to describe factors characteristic of criminality generally. Sutherland's differential association, briefly stated, hypothesizes that crime is a function of learned moralities from significant others. The extent to which persons learn values that favor a criminal act over those that disfavor it will dictate whether they commit a crime. Differential association also states that techniques for committing crimes are learned from other criminals.

In *Other People's Money*, Cressey initially set out to ascertain whether differential association explained embezzlement. The effort was understandable because Sutherland was Cressey's dissertation mentor for *Other People's Money* and insisted that differential association was the most plausible explanation for all white-collar crime.

Cressey abandoned differential association early in his study as a root cause of embezzlement because his research contradicted two main ideas of differential association: that embezzlers should be directly socialized into criminal behavior by other thieves and that they should learn the techniques for committing it from other embezzlers. Many of Cressey's embezzlers did, however, learn neutraliza-

tions favorable to the violation of law from non-significant others when, through contact with co-workers, they came to believe that some business crimes were merely technical violations rather than morally wrong.

Michael Gottfredson and Travis Hirschi's self-control theory would support an explanation of embezzlement if people who commit it also commit a lot of other lower self-control behaviors. An important corollary to the theory is that people who lack self-control are likely to be versatile in their immediate gratification behaviors, both criminal and noncriminal. That is, they will be more involved in theft, violence, accidents, unsafe sex, gambling, drug and alcohol abuse, lying, poor work performance, cheating in college, and any other behaviors that do not defer immediate gratification. Put simply, if self-control theory is correct, then embezzlers must engage in criminal and other deviant behaviors more frequently than those who do not embezzle.

Self-control theory would point, at least anecdotally, to the "wine, women, and wagering" problems, debt-ridden finances, and other lower self-control behaviors (and neutralizations) that are so well associated with embezzlers. More systematic empirical evidence, however, is found in one study of the official arrest records of embezzlers—two-thirds had at least one other arrest. Of them, four-fifths had an additional arrest for a theft crime, a third had an additional arrest for a crime of violence, and a third had a drunken driving arrest. The average number of arrests for the group was six and the median was four.

## CONCLUSION

Embezzlement involves the criminal violation of trust and is a common law offense that can be traced back to the late 15th century. It can be seen as a heterogeneous offense category because it includes acts that are chargeable under numerous criminal statutes, including embezzlement, criminal conversion, fraud, and larceny. Because trust violators commit theft both occupationally and otherwise, and because they represent persons of varying social prestige, the offense category is not in line with the original meaning of white-collar crime. Except in a few isolated cases, embezzlement also lacks criminal organization, which is another criterion for white-collar crime. Because centralized data sources

include this hodge-podge of violators, those sources are inappropriate for the study of white-collar crime. Regardless of the motivation to embezzle—be it a financial problem, greed, gambling debts, or simply the elevation of one's lifestyle—the need is perceived to be real enough to prompt involvement in the offense.

Neutralization of the wrongfulness of embezzlement is often a precursor to participation in the offense, but one need not learn excuses from others, or learn the techniques to commit the offense from others. Persons charged with embezzlement are very likely to be involved in a wide variety of other criminal behaviors.

## SEE ALSO

Sutherland, Edwin H.; differential association; Cressey, Donald; self-control theory.

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## employee crimes

IN THE FIELD OF CRIMINOLOGY, the term employee crime, commonly referred to as occupational crime, is generally agreed to be a subtype of white-collar crime. Beginning with the coining of the term white-collar crime by Edwin H. Sutherland, the broader concept of white-collar crime has been subject to numerous definitional revisions.

For example, it is well known that Sutherland's definition of the term was "a crime committed by a person of high status and respectability, in the

course of his occupation.” This definition immediately calls attention to the fact that the white-collar offender is by nature, legitimately employed. Although it focuses on the characteristics of the individual offender, Sutherland’s most extensive study of white-collar crime actually focused on sanctions against entire organizations, rather than separate individuals.

As a result, the distinction between corporate and occupational crime emerged: corporate crime was considered to be a crime that is committed on behalf of the employing organization, while occupational or employee crime was considered to be committed against the employing organization, to the benefit of the individual. Some debate about this distinction has emerged in the field, mainly in the concern over what types of occupations should be studied. This issue is related to Sutherland’s original concern with the status of high-class, respectable individuals, particularly with regard to the fact that their characteristics often render them immune from legal action.

In spite of ongoing definitional disputes, the distinction between the two forms of white-collar crime has generally been accepted. Researchers studying employee crime may focus on specific occupations, or choose to include a wider variety of offenses that may occur equally often in different occupational settings. Broader conceptualizations of employee crime tend to incorporate a large number of acts that share the characteristic of violating trust: the individual employee violates his or her employer’s trust by engaging in acts that directly or indirectly victimize the place of business.

## TYPES OF CRIME

The Integrity Center, an organization that conducts risk-management assessments for employers, has identified several offenses that are consistent with employee crime. One such offense that may occur in a variety of settings is espionage, which is defined as: the theft or unauthorized acquisition of secret or restricted information. The purpose of industrial espionage is usually related to the acquisition of unique and profitable information belonging to a commercial enterprise. Another common form of employee crime is referred to as kickbacks. Kickbacks are various payments or favors that are given clandestinely to decision-makers in return for selecting the offender’s products or services. Exam-

ples of kickbacks may vary considerably based on the particular industry involved, but could include such common categories as money, gifts, or personal favors.

Fraud is also a general type of employee crime, and can take numerous forms. The Association of Certified Fraud Examiners (ACFE), a leading authority on the topic, has conducted extensive research on what they have termed occupational fraud. This offense is broken down further into three categories: asset misappropriation, corruption, and fraudulent statements. Each of these categories contains yet additional subcategories based on the strategies used to commit them and on the resulting gains (financial or non-financial) for the individual offender.

For example, asset misappropriation, the most common type of occupational fraud, generally consists of one of two forms: cash or other assets. According to research conducted by the ACFE, cash is the asset most often targeted by employees. Misappropriation of cash may occur at all levels of an organization. Corruption, similar to kickbacks, involves collaboration between an inside employee and one or more outsiders in an attempt to defraud the employer in some way that benefits the individual offender. Fraudulent statements, which typically occur at higher levels of organizations, also tend to take one of two forms: the falsification of an organization’s financial statements (for example, overstatement of revenue) or, alternatively, falsification of other documents or records (for example, information in the employee’s human resource file). All of these forms of occupational fraud are violations of trust, and all victimize the employer.

## RELATED CRIMES

Related types of occupational crime include embezzlement, pilferage, and theft of services. The common conceptualization of embezzlement is the taking of money or property by an employee who has been entrusted with its care, custody, or control, which is consistent with the ACFE’s description of asset misappropriation. In the field of criminology, one of the most detailed studies of this type of employee crime was conducted by Donald Cressey, published in his popular 1953 book, *Other People’s Money*.

In this study, Cressey conducted extensive interviews of convicted embezzlers serving time in fed-

eral prison, and found that these former employees had many similarities. All of the offenders were trusted by their employers with money or property. Many of them also identified the fact that they were experiencing a “non-shareable financial problem” at the time of the embezzlement, such as debt due to gambling, blackmail, or womanizing. Many of the offenders also provided common rationalizations for their embezzlement, such as the idea that they were simply borrowing the money from their employer with the intent of eventually repaying it. As a result of this and similar rationalizations, embezzlers did not think of themselves as criminals.

Unlike embezzlement, the employee crime of pilferage generally does not involve the taking of money, but instead refers to smaller scale thefts of relatively inexpensive materials. For example, it may include tools, various office supplies, or other items owned by the employer. Although pilferage is typically viewed as a low-level employee crime, over



*Asset misappropriation, or stealing from the till, is one form of occupational or employee crime.*

time the costs due to this offense can amount to considerable losses for the employer. A similar employee crime is referred to as theft of services. This particular offense consists of the unauthorized use of, or failure to pay for, various services obtained through the employer. Common examples may include making long-distance phone calls or personal photocopying at the expense of the employer.

Other types of employee crimes may be grouped together based on the fact that they involve a similar type of employee: an individual who is bored, feels overworked, has an unresolved dispute with the employer, or is attempting to gain an unfair competitive advantage over her co-workers. Four such employee crimes discussed by the Integrity Center are sabotage, robbery, burglary, and larceny, all of which have a legal counterpart definition.

The broad definition of sabotage consists of a variety of actions, such as the deliberate destruction of property, that are intended to impede the employer's operations in some way. Comparatively, the employee crime of robbery is distinct in that it tends to involve actual force or the threat of force against a victim. Employees may rob their fellow employees, outsiders, or could even give information to outsiders who may use it to rob employees or the organization. Burglary, a related employee crime, entails an employee entering a building or vehicle in an unauthorized manner, and either stealing something tangible or committing another serious crime while inside. Like robbery, burglary can be directly committed by an individual employee, or could also involve a situation whereby the employee provides information to an outsider, who then will physically commit the offense.

Larceny is generally defined as stealing something from a place where an individual has a legitimate right to be present. In the common definition, larceny may consist of a customer shoplifting from a business. Alternatively, and perhaps even more dangerous to employers, is theft by employees themselves. This type of employee crime is also referred to as “shrink” because it involves missing or unaccounted-for inventory. Like all previously described employee crimes, larceny victimizes the employer and can result in large losses, financial and otherwise, over time.

Finally, a newer type of employee crime is any offense that is related to technology, particularly computers. Crimes committed with the use of a computer may be related to or occur in combina-

tion with any of the previous forms of employee crime. Other employee crimes specifically involving the use of a computer include altering data as it is entered into a computer, removing data from a system, or releasing confidential data to unauthorized third parties.

## FIGHTING EMPLOYEE CRIME

What can businesses do to protect themselves from being victims of employee crime? Several strategies have been proposed. Employers may be well served by defending themselves at the pre-employment stage. They can take a variety of steps in the hiring process. For example, one option is to conduct a criminal background check on potential employees. Such checks are relatively simple to perform, and may be conducted by the organization itself or through consultation with a reliable outside agency.

A criminal background check may determine whether a potential employee has any previous arrests or convictions for crimes that may be related to the workplace. For instance, a previous theft conviction may suggest that a potential employee is not an appropriate candidate for a position that involves the handling of money. Employers can use information from criminal background checks to develop general or specific hiring policies. They may decide to bar potential employees who have any prior criminal involvement (even offenses that do not appear to be related to the workplace), or enact a more specific policy that prevents employment of individuals with prior work-related offenses. In conducting background investigations, however, employers should proceed with caution and not rely on a criminal check alone to make a hiring decision. Recent research on this topic has suggested that some individuals may have extensive histories of employee crimes, but this information will only be detected in a criminal background check if the individual's prior employer took legal action against the offender.

All too often, employers may choose simply to dismiss the offender due to fear of negative publicity or to avoid the expenses of a criminal trial. When conducting background checks, employers should also carefully check prior references in an attempt to uncover any relevant information that may go undetected by a criminal check. When employers choose to severely punish offending employees, they can also ensure that future businesses will de-

fect the behavior in subsequent criminal background checks.

To prevent crimes by existing employees, businesses have a number of potentially useful options. In the past decade, technological advances have made the prevention and detection of employee crimes easier to accomplish. One readily available technique is the installation and use of closed-circuit television monitors. Cameras can be installed at a variety of locations: randomly, throughout a business, or even directed specifically at a location where cash transactions take place, such as above a cash register or customer service counter. This type of preventative technique is common in retail settings, and also serves to detect crimes committed against the business by the general public (such as shoplifting). This option involves close monitoring by a trained security team, and immediate action when a crime is detected. The enactment and publication of strict security policies, such as an automatic report to local police and/or a 100-percent prosecution policy may go a long way in deterring the potential employee criminal from acting.

One of the problems with employee crimes is that many of them are not so easily detected through procedures like cameras that may regularly catch common shoplifters. For example, corruption and fraudulent statements, two forms of occupational fraud, may often involve transactions that are not obviously witnessed. Several options are still available to detect such offenses. One potentially beneficial strategy is the implementation of an anonymous reporting system so honest employees can tip off the employer about the criminal activities of other employees. An anonymous reporting system could consist of a 24-hour, toll-free hotline that employees could call when they are away from work, or it could also take the form of a suggestion box or random survey where no identifying information is required. Regardless of the format, anonymous reporting systems can encourage employees to report crimes without fear of retaliation by the offending employee.

In addition to background checks and anonymous reporting, research by the ACFE has revealed that two other practices may be useful in the detection of employee crimes. These mechanisms are internal audits and external audits. Both serve a similar function, which is a thorough assessment and reconciliation of a businesses' financial accounts, documents, or related information. While

both internal audits and external audits could benefit the organization, the internal audit may be ineffective if it is related to the source of the crime itself. An external audit by a non-related, third party, especially if it is conducted unannounced, may be more useful for the discovery of employee crimes.

In the balance of severity and harm caused by white-collar crime, employee crimes rank, for the most part, as almost innocuous compared to the staggering cost in lives and money of corporate crimes, those committed not necessarily by employees, but more likely, employers.

#### SEE ALSO

embezzlement; kickbacks; employee theft.

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## employee safety

EVERYDAY millions of Americans go to work with the expectation that they will return home unharmed. However, this is not the case for everyone. In 2001, there were 5,900 worker-related deaths and 5.2 million injuries and illnesses according to the Bureau of Labor Statistics. The rate for 2001 fatalities, injuries, and illnesses was the lowest since the bureau began collecting this information in the early 1970s, but the rates, most scholars agree, are still unacceptably high. Many of these cases are caused by egregious and willful safety violations. It is very rare for employers to be held criminally liable, let alone be imprisoned, for violation of state and federal safety laws.

The Occupational Health and Safety Administration (OSHA) is the main federal regulatory

agency charged with the health and safety of workplaces for employees in the United States. OSHA was created in 1970 from the Occupational Safety Health Act (OSHA act). The act's stated goal is to ensure that every working person and woman in the United States has safe and healthful working conditions. The law has given employees a wide range of rights. One of these rights requires companies to reduce risks in the workplace, and if there are risks, then employees have the right to fight for their health and safety.

During the 1980s, OSHA's budget was drastically cut and this had a major impact on the ability of OSHA agents to conduct inspections. Inspections are the main tool used to make sure that companies comply with safety standards that are set for each industry. In 2003, OSHA had 1,123 inspectors who were charged with overseeing approximately 7 million worksites that employ over 111 million workers. OSHA had 1,388 inspectors in 1980.

The United States has seen an increase in worksites and employees but a decrease in the number of inspectors. Because OSHA is so strapped for inspectors, it allows many of the states to take over this responsibility. Section 18 of the Occupational Safety and Health Act of 1970 encourages states to develop and operate their own job safety and health programs. OSHA approves and monitors state plans.

The OSHA act provides for criminal sanctions in various situations. If an employer willfully violates a standard, rule, order or regulation which causes the death of an employee she may be held criminally liable. If an employer makes a false representation regarding compliance with the OSHA act this too may make him criminally liable. Employers may be subject to civil and criminal fines and, in rare instances, imprisonment. A willful violation is a voluntary action that is done with either intentional disregard of or with plain indifference to the statutory requirements. Malicious intent is not required to impose liability.

#### CASE HISTORIES

Some historical cases of willful violations include particular industries, like coal mining, asbestos, and many textile factories. One of the first major coal mine disasters of the television age occurred in 1968 when 78 men were killed in an explosion in a coal mine in Farmington, West Virginia. The igni-

tion source that set off the original explosion never could be determined. However, investigators did find a classic combination of factors, including inadequate ventilation, inadequate control of explosive methane gas and coal dust, and inadequate testing for methane, that could have set the stage for the explosion.

The use of asbestos and its harmful effects have also created unsafe working environments. Many of employees who had asbestosis, a type of lung cancer, have sued Johns-Manville, a major manufacturer of asbestos. Court documents confirm that Johns-Manville knew of the hazards associated with asbestos and intentionally kept the information from its employees. In fact, the asbestos industry had a long-standing policy of suppression. The industry did not warn workers of the dangers of asbestos exposure until 1964.

Textile workers in North and South Carolina have had high rates of byssinosis, an irreversible respiratory disease caused by the ingestion of textile fibers, like cotton dust. In 1980, an estimated 35,000 workers were inflicted with this deadly disease. Working in a factory can be dangerous work, but when one is not told of the dangers or is fired for organizing protests of unsafe work conditions, then this may be criminal. Many executives in the textile industry spent decades denying the very existence of byssinosis. In some cases, the factories would hire company doctors who were told to tell employees that they were fine or simply had bronchitis. Many of the employees had no understanding that their illnesses were caused by the industry's criminal negligence in not creating a safe working environment.

There have been several cases where owners and managers have been held criminally liable under state law for willful violation of safety standards, but these are atypical. Two specific instances of successful criminal prosecution include the Film Recovery Systems, Inc. and Imperial Food Products cases. On June 14, 1985, Steven O'Neil, Charles Kirschbaum, and Daniel Rodriguez, agents of Film Recovery Systems, Inc. were convicted of murder in the death of Stefan Golab, an employee, from cyanide poisoning. In 1990, on appeal, their case was reversed and remanded for a new trial. On September 7, 1993, the three former employees entered guilty pleas of involuntary manslaughter.

In September 1992, the owner of Imperial Food Products, Emmett Roe, age 65, pleaded guilty to in-

voluntary manslaughter and was sentenced to 20 years in prison for his responsibility in the deaths of 25 of his workers.

State and federal regulatory agencies like OSHA can only do so much given the lack of budget and inspectors. It is the responsibility and legal duty of an employer/company to create and maintain a safe working environment for employees.

#### SEE ALSO

workplace violence; workplace deaths; Occupational Safety and Health Administration; Johns-Manville; Film Recovery Systems, Inc.

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## Enron Corporation

**ACCOUNTING FRAUD CAUSED** the seventh-largest corporation in United States to fall victim to white-collar crime. Its demise was due to accounting practices in violation of Securities and Exchange Commission (SEC) regulations. It is the classic case of the devil in the details. From its founding in 1981 until the late 1990s, Enron was a dynamic, expanding energy corporation. The larger it grew, the more it diversified.

The accounting fraud at Enron was complex, but it is why it collapsed. Enron annual reports to shareholders stated very high earnings but kept nearly all its debt off the annual reports by stating in a footnote that a special purpose entity (SPE) covered the debts. The use of special purpose entities is a legitimate practice but there are federal regulations that were violated by Enron. A special



purpose entity guarantees a debt for a price, which is its profit. First, though, it must have the assets to cover the debt. Second, SEC regulations requires it to be headed by a person not connected with a corporation which covers the debt. Third, investors in the special purpose entity must have sufficient capital at risk. None of these regulations were observed for the SPEs created by Enron officials.

Enron's chief financial officer, Michael Fastow, created special purpose entities incorporated under the names LJM 1 and LJM 2 (his wife's and children's initials) among others directed by different Enron officials. These SPEs were just post office boxes and bank account numbers in the Cayman Islands. Fastow was president of both SPEs while at the same time an Enron executive in violation of SEC rules and Enron's own internal code of ethics. LJM 1 and LJM 2 had no capital at risk. Their entire assets were Enron's own money backed up by its stock. Fastow transferred hundreds of millions of dollars to LJM 1 and LJM 2 every year from 1997 to 2001. It was deposited in LJM accounts and returned to Enron minus the fee for covering Enron's debt. The fee included Fastow's salary as president of the SPEs and dividends for SPE shareholders. The amount returned to Enron was then listed in the revenue column on the annual report and debt in a similar amount erased from the liability column. As a result, Enron's annual report showed very high income and virtually no debt, making it very attractive to investors.

The prudent decision would have been for Enron to use its high income to pay its debts. However, that would have left much less for shareholder dividends and would cause stock prices to advance at a slow rate based on the actual profitability of the corporation. Fastow and other Enron executives were major shareholders. Every year, 1997 to 2001, stock prices climbed and dividends were paid based on what appeared to be record financial performance.

In reality, the debts grew ever larger year to year until they reached \$1.2 billion. At that point Enron declared it must revise its financial statements. As its stock value fell and the SPEs had no assets, bankruptcy was the unavoidable consequence.

On January 13, 2004, Fastow pleaded guilty to two felonies, becoming "the highest ranking officer at the company to admit to participating in crimes that contributed to Enron's collapse into bankruptcy protection more than two years ago," the

*New York Times* reported. In his plea, Fastow admitted he had worked with other executive officers of Enron, including possibly Chief Executive Officer Ken Lay, "to disguise Enron's deteriorating financial health, as well as engaging in a scheme to defraud Enron of millions of dollars for his own benefit."

The business media reported prosecutors recommended that Fastow serve a 10-year sentence, the maximum under the two counts to which he pleaded guilty. The former chief financial officer faced an additional 96 counts, and settled related civil charges with the SEC. Fastow agreed to surrender more than \$23 million in civil and criminal penalties. The deal with Fastow led prosecutors to believe they had reached high enough into the Enron corporate suite to determine whether Lay or other chief executives were involved in Fastow's creative bookkeeping.

#### SEE ALSO

accounting fraud; offshore entities; Caribbean islands; corporate liability; Securities and Exchange Commission.

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## Environmental Protection Agency

BEFORE THE Environmental Protection Agency (EPA) was created in 1970, earlier legislation had been enacted to protect the environment. However, these laws were weak, and poorly managed and enforced.

The first environmental law in the United States was called the Rivers and Harbors Act of 1899 or the Refuse Act. This law was primarily designed to bar companies from discharging garbage

into navigable waterways. Clearly, this first law was aimed at protecting commerce not the environment. However, two later Supreme Court decisions mandated that dumping industrial waste, whether or not it interfered with commerce, was still a violation of the law.

In the 20th century, the first environmental law was the Federal Insecticide, Fungicide and Rodenticide Act passed in 1947 requiring companies to register pesticides used in interstate commerce. Public concerns about the environment arose in response to the post-World War II burgeoning industrial development and use of chemicals, as well as the nuclear fallout from the use of two atom bombs by the United States against the Japanese cities of Nagasaki and Hiroshima during World War II. This series of new environmental legislation included the Water Quality Act of 1948 and its expansion in 1956 by the Federal Water Pollution Control Act. This act created the Federal Water Pollution Control Administration that would approve new water-quality standards.

## POWERFUL ENVIRONMENTAL LAWS

Also in 1955, the Air Pollution Control Act was passed. This was followed by the 1958 Food Additive Amendment or the Delaney Amendment requiring the Food and Drug Administration to ban any food additives that were suspected of causing cancer. However, it wasn't until 1962, when a book, *Silent Spring*, written by Rachel Carson was published, reflecting the public's growing concern about the effects of synthetic chemicals on all living things. More powerful environmental laws and finally, the Environmental Protection Agency was created.

In 1963, the Clean Air Act was passed and initially gave the secretary of Health, Education, and Welfare the power to define air quality based on scientific research. Then in 1969, after one of the Great Lakes (Lake Erie) was declared dead as the result of industrial pollutants, and an oil spill off the California coast led to extensive damage to wildlife, the demand for an Environmental Protection Agency was further empowered. In 1969, by executive order, President Richard Nixon created the EPA, designed to enforce the new 1970 Clean Air Act. The EPA was initially charged with the responsibility of identifying air pollutants hazardous to humans and to publish air-quality criteria through

the National Ambient Air Quality Standards. These standards mandated two levels of protection for health and welfare and required the states to develop similar implementation plans to protect the air. In the early 2000s, many states still had not met the required standards set up by the EPA.

From 1972 through 1982 the U.S. States Congress created or amended a variety of pieces of legislation designed to control and manage polluting industries and sanction, fine, or punish those companies that violated these regulatory laws. All of these laws are administered or enforced by the EPA and include the following:

1. The Resource Conservation and Recovery Act focuses on the control and management of solid hazardous waste products. It is responsible for ensuring that such waste is properly generated, transported, treated, stored, and/or disposed of. Beginning in 1989 under this law, the EPA began producing the Biennial Reporting System (BRS) database that provides the identities of companies producing waste as well as the volume of waste produced by primary hazardous waste generators. However, this list omits a number of facilities.

2. The Toxic Substances Control Act requires pre-manufacture notification of any new chemicals being developed. It requires testing of any chemicals that are not already regulated by the Food and Drug Administration (FDA).

3. The Comprehensive Environmental Response, Compensation and Liability Act is aimed at repairing environmental harms (see below).

4. The Federal Insecticide, Fungicide and Rodenticide Act targets restrictions in the use of pesticides.

5. The Federal Water Pollution Control Act of 1972 was the first major law requiring a comprehensive approach to discharges of waste and led to the development of an extensive permit system.

6. The Clean Air Act of 1970 is designed to define air quality standards and required the EPA to identify air pollutants and publish air quality standards through the National Ambient Air Quality Standards list.

The Pollution Prevention Act of 1987 authorized the collection of pollution data maintained in the Toxic Release Inventory (TRI). The TRI is available on the internet and lists the toxic chemicals transferred or released by manufacturers with more than 10 workers, producing over 25,000 pounds of or uses more than 10,000 pounds of one of the 350

identified toxic chemicals. The TRI includes air, land, water and underground releases. It is the responsibility of the EPA, as the law enforcement agent of environmental laws, to ensure that all industries comply with the requirements by negotiating compliance, and using the administrative or civil law to sanction or fine companies if they do not voluntarily comply with the law, as well as clean up any pollution that they have caused.

As a last resort, uncooperative violators are referred to the Department of Justice for criminal prosecution with penalties that can include fines and prison for responsible company executives.

The EPA is one of the largest of all the federal regulatory agencies. It has 10 regional offices that include environmental attorneys, investigators, and administrators. The EPA is a part of the executive branch of the federal government and is headed by an administrator, deputy, and nine assistant administrators nominated by the president. It should also be noted that the EPA also works with state environmental protection agencies in achieving enforcement functions. Each state negotiates its particular degree of involvement in environmental protection with the federal EPA.

Unfortunately, the EPA has no authority to intervene in the event of hazardous waste or pollution emanating from chemical or nuclear weapons that belong to the U.S. government. These issues remain under the control of the Department of Defense. Moreover, the EPA cannot control U.S. transnational corporations who violate environmental laws when they are operating overseas.

## THE SUPERFUND PROGRAM

In 1980, the Love Canal environmental disaster led Congress to enact the 1980 Comprehensive Environmental Response, Compensation, and Liability Act authorizing the EPA to create the superfund program to facilitate the clean up of hazardous waste sites. This act imposed taxes on crude oil and certain chemicals to provide the capital for the superfund. Unfortunately, as of 2004, it was no longer authorized to gather taxes. However, the previous taxes continue to be received because of past due taxes and Treasury Department adjustments.

A superfund site is authorized when an industrial or individual pollution event occurs and creates a significant danger to people, animals, and the environment. Superfund sites are considered very

dangerous, real threat but another type of site is referred to as a Brownfield. A Brownfield site is defined by the EPA as an abandoned, idled, or underused industrial or commercial facility where expansion or redevelopment is complicated by real or perceived contamination. Such sites do not require clean up as a superfund site does. What remains problematic is that the average site remains on the superfund list for clean up for almost 11 years.

In response to this problem, Congress passed the 1986 Superfund Amendments and Re-authorization Act mandating that superfund sites end up on the National Priority List for clean up within four years of the discovery, although this legislation has not changed the time agenda. Ending up on the National Priority List is the third step of an eight-step superfund investigative process conducted by the EPA, ending in a record of decision and the plan for remedial action.

In addition to the Brownfield list, the Toxic Release Inventory and the superfund database exist to record accidental chemical releases into the environment from fixed facilities. This is called the Accidental Release Information Program Data and any release that may cause injury or death to humans or damage to the soil, water, air, or wildlife must be recorded there. All information relevant to the location, company, and amount of and type of toxins released are specified on the list.

Growing scientific evidence reveals that many polluting industries and superfund sites are near predominantly poor or minority communities. While these blatant forms of classist and racist environmental crime remain permissible by law, some criminologists argue that such crimes are a violation of the equal protection clause of the 14th Amendment. Further evidence of this racism exists in that minority superfund projects are on the National Priority List longer than other sites, and generally take longer cleaning-up than other sites.

In a makeshift effort to address this issue, President Bill Clinton signed an executive order requiring all federal agencies to make environmental equity a part of their mission. In 1992, the EPA created an Office of Environmental Equity, now called the Office of Environmental Justice. This office has commissioned a task force to examine environmental equity issues that oversees the National Environmental Justice Advisory Council, a federal advisory committee of citizens who offer guidance to the

EPA. Additionally, in 1993, the EPA made a series of administrative changes, making the superfund program faster and more efficient. As of 2000, the active site remediation was completed at 43 percent of the National Priority List sites, and 12 percent of sites were deleted from the monitoring program. However, toxic releases and emissions continue to grow and remain problematic across the United States as well as across the globe; many of these releases and emissions contain materials that are carcinogenic.

Internationally, protection of the environment is becoming a protected right of all peoples. The right to a healthy environment exists in international law in the Covenant on Economic, Social and Cultural Rights, which the United States has not ratified. Also, the Rio Declaration is a binding international treaty obliging all nations to recognize the right to a healthy environment; only 34 out of 190 nations have not signed this agreement. In addition, the Montreal Protocol on Substances that Deplete the Ozone Layer has been ratified by 112 nations.

#### SEE ALSO

air pollution; water pollution; Clean Air Act; Clean Water Act; Justice, Department of; Love Canal.

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## Equity Funding Scandal

THE EQUITY FUNDING Corporation of America was a life insurance company capitalized in 1960

with a few thousand dollars, which by 1973 claimed assets of \$1 billion making it the first white-collar crime to break the billion-dollar mark. The Equity scandal illustrated there is almost no limit to the dollar amounts that can be fraudulently obtained and can go undetected for over a decade.

Equity fabricated non-existing assets and sold them. To understand how the scheme worked requires noting certain practices in the insurance industry. Insurance companies buy and sell policies they issue to other companies, which is called reinsurance. This spreads risk evenly over all companies so, in the event of multiple claims, they do not fall too heavily on one insurer. For example, consider that one company wrote all of the homeowner policies in Florida and a hurricane caused billions of dollars in claims. It would endanger the company's financial stability to pay them all. But if many companies share the risk, each pays a portion of the large number of claims. The same practice applies to life insurance.

Knowing there is a ready market for life insurance policies among other insurance companies, the founders of Equity Funding forged policies by writing insurance on nonexistent people or "fence posts." Secretaries made up fake names, ages, medical histories, addresses, and premiums on forged applications. When several thousand applications were forged, they were assigned policy numbers and entered into the company computer. These policies were sold to other insurance companies in routine reinsurance transactions for large sums of money. The company buying the policies could expect to collect premiums on some policies for decades.

Of course, in a month the first month's premiums are due and will have to be forwarded to the company that bought the policies from Equity. In the meantime, more fake policies were issued and sold to another company, and the first month's premium due to the first was paid from funds received from the second. Money from the sale of the fake policies went into Equity's account. Since the price paid by other insurance companies was so much higher than the premiums due on earlier policies, Equity's cash assets skyrocketed.

With massive revenue flowing in and only a few employees needed to carry on the fraud, Equity began to legitimize operations by hiring real agents. With the ever-increasing flow of money from forged policies, Equity could offer insurance products that no other company could match. Offers included

life insurance with a cash-value so high, the insured paid virtually no premium for coverage. Sales volume naturally increased giving Equity an ever-expanded market share, causing its stock price to go up on average 166 percent annually. Such a well-performing stock attracts investors. Labor unions invested pension funds and colleges and universities added Equity stock to their endowments. Tens of thousands of private investors made substantial investments.

As Equity sales and stock prices advanced, other companies became worried. They had more agents than Equity, yet they could not write that much insurance. Some reasoned that if given a chance, Equity policyholders would also buy their products. Taking names and addresses from policies that they purchased in reinsurance deals, the companies mailed literature offering Equity policyholders their products. When all offers came back from the post office marked "address unknown," the fraud was exposed.

Equity Funding was shut down in simultaneous actions by the insurance departments of several states. Quick action across the country was necessary to deprive Equity of a chance to cover up the crime. Once the fraud was exposed, holding Equity stock or policies was a total loss to all investors and policyholders.

#### SEE ALSO

insurance fraud; Ponzi schemes; scams; accounting fraud; investment fraud.

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## ethics

ETHICS IS A WORD used to refer to a range of personal decisions relating to issues of morals or principles. It includes issues of morality: what is right and wrong and, hence, how should we live and how should we behave? These questions are clearly

contingent upon culture and dependent upon time and situation. This is because different groups of people profess to believe in the correct way to behave, and promulgate various codes of behavior and values that are claimed to cover all eventualities. These codes often conflict with each other and, from an analytical-ethical perspective, most have some useful content which can help people live together peacefully, but none is sufficient to deal with all the complexities of the modern world.

The range of possible circumstances in which people may find themselves and the decisions they might have to make are so wide that simple definitions are inadequate. Instead, an eclectic approach is required and this helps to explain the tremendous growth of schools of business ethics, with professorial chairs and peer-reviewed journals devoted to the concept.

In the business world, ethics is used in a general sense to refer to the obligations and responsibilities of firms to their stakeholders. Stakeholders are all those individuals and organizations to whom the behavior and existence of the firm is in some ways significant. This can include employees (who rely upon the firm for regular wages), shareholders (who anticipate return on their investments), suppliers of intermediate goods and raw materials (who rely on the firm for their own business survival), and neighbors (who may be affected if the firm causes some form of environmental degradation), as well as many others.

As large firms continue to become internationalized, undertaking different sorts of business activities in different countries, it is clear that they may develop a complex network of stakeholders who, in some cases, will have competing and even contradictory calls on the firm's attention and resources. The need for firms to ensure highest returns for shareholders and investors may, for example, conflict with the interests of employees, when the firm decides to export jobs overseas to countries where labor costs are lower, as in the case of Aviva, which decided that more than 2,000 administrative and telecommunications answer-centre calls were to be relocated to India.

A particular issue of contention has arisen with the growth of importance of the American business model, which argues that the only legitimate purpose of business is the constant pursuit of short-term profit maximization and which is closely associated with conservative thinkers in the United

States and elsewhere. The American business model ruthlessly pits the firm's responsibilities to its shareholders against its responsibility to any other stakeholder, and dictates that the latter must be subservient, no matter what the cost to society and individuals. The interest in business ethics has been further stimulated by these developments.

## CONTEXT

The debate about business ethics has intensified considerably over recent years as a result of a series of factors. These include the distaste shown by the public concerning a series of high-profile financial scandals by firms, combined with reports of excessively high levels of compensation provided to executives, seemingly irrespective of corporate performance. The U.S.-led attack on Iraq in 2003 inspired additional debate about the role of corporate interests in shaping foreign policy, particularly with respect to the president and cabinet's very close linkages with the U.S. oil industry, and the controversial award of reconstruction contracts in Iraq with the suspicion of conflict of interest.

Additionally, the entry into the capitalist market system of the states of the former Soviet Union, and the disaster of the International Monetary Fund (IMF) program of privatization in Russia have also highlighted the need to instill elements of ethical behavior into the market system. Under command economy systems, there is little need for an ethical component since all economic decisions are driven by systematic ideology. However, as has been seen in those countries undergoing transition from command to free market economies (such as in Russia, Poland, and China), alienation of the people from what appears to be a predatory state leads to a high degree of corruption and fraud in business practices.

At the same time, the impact of globalization (defined in this sense as increased availability of international travel and of the distribution of information internationally) has led to the interaction between economic actors from different cultures to a much greater extent than ever before. Not only, therefore, have business people been required to deal with different, and in some cases incompatible, ethical standards in appropriate manners but information about those dealings is now increasingly available to stakeholders around the world. Consequently, legislation has been required to regulate,

for example, the interface between U.S. company representatives and Japanese or Korean employees involved with the gift-giving corporate culture widely prevalent in those countries, which has resulted in the imposition of new guidelines and the redefinition of the concept of bribery.

As more states have become involved in the global trade and investment system, production capacity has also necessarily increased and, as a result, competition between firms has intensified and the focus of competition has switched from production values to marketing values. In other words, marketers are selling products based not so much on what they can do, but on what they look like or what image and status they might provide. Consequently, there is a greater incentive for marketers to stretch the limits of description for their products and this means a greater requirement for ethical standards to which marketers should adhere.

## HISTORICAL PERSPECTIVE

Historically, all major societies have regulated business-state activities by recourse to the dominant religious ideology or ideologies. Combined with specific societal, cultural, and geographic factors, this led to a series of unique relationships between state rulers and those involved in economic activities. Commerce was variously considered to be a rewarding and moral activity (in Islamic societies), a necessary evil best regulated carefully (China and some other Oriental states), or a recourse from persecution for a people unable to own property in many countries (among some Jewish societies).

The interaction of different cultures involved in trade generally led to the creation of markets in which customs and regulations would be blended together in the interests of trading efficiency, while remaining under political control of the domestic government. One example of this was Ayutthaya, in what is now Thailand, where communities of European, Arab, Chinese, Japanese, and other merchants were able to deal with each other under conditions guaranteed by the state.

Through markets such as these, leavened by the occasional external shock of a powerful new entrant into the market who was able to shake up trading conditions, international standards were set in the pre-modern era. Ethical decisions concerned such issues as the degree to which contracts with nonreligionists must be considered valid, and the

implications of using violence to ensure trade routes or in piracy.

In the modern age, improved communications and technology stimulated the creation of international banking and finance, as well as more sophisticated transactions, which necessitated improved methods of ensuring trustworthiness and reputation. Meanwhile, labor standards remained in a rudimentary state and, as a result of the Industrial Revolution and the imposition of colonial empires, grew significantly worse in many cases.

The 20th century saw understanding of the values of human rights, labor standards, and environmental sustainability slowly seep into the business world, although very frequently only after lagging behind legislation. The growth of consumerism and the civil society helped to change the global environment in favor of the rights of people to live free of ideology, whether political or religious, albeit only in some parts of the world. These attitudes inspired firms to engage with ethical concerns on a more genuine basis, and a number of important gains was made in terms of employee safety and rights and in the responsibility taken for the safety of products. However, the progress of these improvements continues to be subject to the prevailing political climate, as some conservatives strive to divorce corporations from social responsibilities.

### ETHICAL STATEMENTS BY FIRMS

Firms are increasingly coming to include ethical statements of various sorts as part of their corporate mission, or else as some other formal part of their statements of principles. They are motivated by a combination of philanthropy and corporate citizenship, on the one hand, and the desire to deflect unwanted and negative ethical investor attention, on the other. In some cases, the statements appear to be somewhat self-important but visionary, as in Ford Motor Company's 2003 statement:

Our Company was built on values. They helped us succeed to this point and will support the drive to a more sustainable future. To inspire us to make our values come alive in our current business practices we have adopted a set of Business Principles for our next 100 years.

The Samsung Corporation, on the other hand, reveals in a series of mission statements, its role as a

supporter of Korean development and increasing independence of action. At first, its mission was "Economic contribution to the nation," followed by "Priority to human resources" and then "Pursuit of rationalism." Finally, it reached this position in 2003: "We will devote our human resources and technology to create superior products and services, thereby contributing to a better global society."

Samsung's example is one which many other corporations have followed, it and reveals an understanding that it is now necessary to promote the organization as subscribing to a number of values considered important by consumers and stakeholders. However, whether they will actually conform to such standards is much less clear.

### ETHICAL STANDARDS

Ethical decisions vary according to the functional department in which people are involved and their level of seniority. Functionally, the decisions facing marketing departments are different from those facing accounting or production departments. In the case of accounting, international standards are promulgated and distributed around the world, while the growing acceptance of English as the language of international business is leading toward shared accepted definitions of various concepts and practices. In some functional areas, international or at least national standards of behavior and ethical practice are being established to serve as a filter against poor practice, but also as a barrier to entry for smaller firms.

Managers are required to perform ethically with respect to their duty, their dealing with external stakeholders, and with both their supervisors and subordinates. Depending on their level of autonomy, managers may also be required to make significant decisions concerning the firm's relations with the rest of the world. Country managers, for example, who represent their firm as senior manager in a particular country, may have to make decisions about complying with or rejecting local ethical systems which may appear to be unacceptable. These might include monopolistic distribution systems, payment of commissions or other special payments that may be construed as bribes, or the avoidance of international health and safety regulations.

Employees are also faced with the issue of whistleblowing, which is the practice of alerting the media or regulatory authorities of wrongdoing by

the firm, whether in terms of breaches of safety or labor standards, or else commission of internal fraud or malpractice that may be kept within the organization.

While it is clear that the employee has a moral duty to reveal details of wrongdoing, actually doing this in practice may be made more difficult because of fear of reprisals and job loss. The mixed outcomes of people who have blown the whistle on their employers has led the U.S. government to support individuals through accountability programs.

## THE GLOBAL COMPACT

Since the range of circumstances in which a decision with ethical content may be required is so wide, and the ability of individuals to obtain and process accurately sufficient information to make an informed decision so limited, it is necessary to provide guidance on basic values and moral principles. Many organizations have attempted this and their efforts often reflect their own sets of interests. In other words, they only partially deal with all the issues required of them.

As a result, the United Nations (UN) has attempted to integrate basic building blocks of business ethics into a set of guidelines that has become known as the *UN Global Compact*. In response to a challenge issued by UN Secretary-General Kofi Annan in 1999, a network of organizations and individuals published the *Global Compact* in July 2000 centered upon nine principles relating to the conduct of business as it relates to human rights, labor standards, and the environment:

### Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence; and

Principle 2: make sure that they are not complicit in human rights abuses.

### Labor Standards

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labor;

Principle 5: the effective abolition of child labor; and

Principle 6: eliminate discrimination in respect of employment and occupation.

### Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges; and

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technology.

The network of the *Global Compact* works to promote these principles and to extend their meaning into all areas of business decision-making. One particular issue is to provide compelling reasons for firms to participate and follow the guidelines. This involves focusing upon the return on investment that it is possible to obtain from adhering to a stated ethical code, and the need to ensure that published ethical statements are not only being adhered to, but are inherently meaningful and not just another form of marketing fraud.

### SEE ALSO

corporate liability; globalization; self-control theory; board of directors; Ethics Reform Act.

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## Ethics Reform Act

IN THE LATE 1980s, U.S. Congressional ethics were under extensive public scrutiny, and the result was an environment that was ripe for reform. With the Ethics Reform Act of 1989, which became law in November 1989, Congress established restric-



tions on the ways that federal employees could earn money beyond their government salaries. The restrictions were applied to honoraria, gifts, and campaign contributions. Inevitably, Congressional attempts to ensure ethical behavior on the part of federal employees stirred up controversy in the media and the public.

In the midst of an economic recession, the House of Representatives added a provision to the Ethics Reform Act that increased annual salaries for all members by approximately 51 percent. Supporters of the bill argued that increasing salaries would offset the loss from honoraria and would protect members from being corrupted by special interests. The Senate initially bypassed the salary raise and retained the right to accept honoraria. However, in response to public outcry, at the beginning of the following term the Senate also banned honoraria for Senators and Senate staff, and the House of Representatives voted to eliminate the pay raise. Reactions to the raises at a time of economic crisis contributed to the resignation of Speaker of the House Jim Wright (D-TX) on June 30, 1989.

The Ethics Reform Act also attempted to deal with the ethics surrounding the huge war chests comprised of monies left over from political campaigns. Ten years before, Congress had prohibited members of Congress from converting these funds for personal use. The 1979 law had provided a "grandfather clause" that exempted members of Congress who took office before January 1980. The new act removed that exception, allowing members who left office before January 1993 to maintain control of their war chests. In 1989, 179 members of Congress remained who had been exempted from the 1979 act by the grandfather clause.

### TAKE THE MONEY AND RUN

Some members chose to take the war chests and leave Congress. Gene Taylor (R-MO), for example, used his war chest to pay automobile insurance, income tax, and to host a party for his Congressional staff. He then donated \$52,000 to charity and wrote himself a check for \$345,000. Others who left Congress with huge war chests were Marvin Leath (D-TX) with \$844,000, Doug Barnard (D-GA) with \$555,000, and Robert Whittaker (R-KS) with \$524,000.

Those who remained in office were allowed to use funds from their war chests to campaign for any

other, entirely different political office than the one for which the money was originally donated.

The Ethics Reform Act also banned government officials, including all employees of the executive and judicial branches and members and staff of the House of Representatives, from accepting honoraria for giving speeches or writing articles. The Ethics Reform Act defined honoraria as "money or anything of value for an appearance, speech, or article, excluding any actual and necessary travel expenses." This restriction, which was added to the bill at the last minute, proved to be so controversial that challenges reached the Supreme Court of the United States. While the intention was to limit the impact of special interests on federal employees and to prohibit federal employees from acting for special interests, the end result was an outright ban on such activity by federal employees, even when the speeches or articles were unrelated to their federal jobs.

The ban had particular impact on the two million or so employees who worked in the executive branch of government. Federal employees who were adversely affected by the ban included a lawyer for the Nuclear Regulatory Commission who wrote articles on Russian history, a mail carrier who gave speeches about Quakerism, a Labor Department lawyer who lectured on Judaism, an aerospace engineer who lectured on African-American history, a Food and Drug Administration employee who wrote dance reviews, and an Internal Revenue Service (IRS) employee who wrote on environmental issues.

After a number of unsuccessful Congressional attempts to lift the ban on honoraria, federal employees brought a class-action lawsuit, claiming that the First Amendment rights of all federal employees had been threatened by the ban on accepting payment for speeches and articles. In 1995, in *United States v. National Treasury Employees Union* (514 U.S. 527), the Supreme Court upheld the rights of federal employees and overturned the honoraria portion of the Ethics Reform Act of 1989 as it applied to employees ranked GS-15 and below.

Writing for a six-to-three majority, Justice John Paul Stevens used the examples of writers Nathaniel Hawthorne and Herman Melville who had worked for the U.S. Customs Service to argue that federal employees should be given the opportunity to make contributions to the "marketplace of ideas."

## SEE ALSO

corruption; bribery; ethics; campaign finance; Ros-tenkowski, Daniel.

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## extortion

EXTORTION IS A CRIMINAL offense, generally described as obtaining something of value from one party by the infliction of harm, or the threat of that infliction of harm by a second party. Extortion is different from theft; in a theft, the item (a physical object) of value is usually taken without the owner's knowledge and/or permission, so no force is present.

Similarly, extortion is different from robbery; in a robbery, violence is either present or implied, not understood to be a future occurrence. Additionally, most robberies involve the taking of a physical object, not an abstract or immovable instrument, that is, a reputation, future business contracts, or occupancy of a building. Extortion often involves the payment of monies to ensure that violence will not occur, sometimes referred to as protection money.

The generally accepted public conceptualization of extortion is one of two classifications: a politician demanding payments from persons seeking business from a political body (corruption, bribery, graft), and organized-crime figures demanding

money from business owners to avoid physical injury or damage (paying protection). However, extortion exists in many forms, including: individual on individual, individual on public figure/politician, individual on corporation, individual on governmental agency, politician on individual, politician on corporation, labor unions and law enforcement personnel on individual, organized-crime operation on individual, and organized-crime operation on corporation, as well as certain ethnic extortion operations.

Extortive demands made against individuals and corporations, in both domestic and overseas markets, have increased in such regularity that insurance coverage is now offered by several major insurance carriers; insuring such risks as: kidnapping/threat of kidnapping, bodily injury extortion, property extortion, product contamination, and trade-secret extortion. Some insurance carriers note their success in reducing kidnapping payments from the original demands, and usually settling for 10-25 percent of the original demand.

## THE HOBBS ACT

The crime of extortion is often associated with the Hobbs Act, which is defined in 18 U.S.C. S 1951 (b)(2), which describes extortion as the "obtaining of property from another, with or without his consent, induced by wrongful use of actual or threatened force, violence, or fear, or under the color of official right." Certain standards must be met for an act to be identified as extortion under the Hobbs Act and for a person to be charged with violation of the act, including: 1) Did the defendant induce or attempt to induce the victim to surrender property or their rights to that property? 2) Did the inducement include either physical injury or economic harm? 3) Did the action potentially or actually affect, delay, or obstruct interstate or foreign commerce? And 4), was the threat of physical injury or economic harm wrongful—did the defendant have intent to obtain the property or right thereof by the threat of force?

## GANGSTER EXTORTION

Similar to the irony of Al Capone being convicted on tax evasion charges, extortion charges hastened the demise of fellow Chicago gangster, Frank Nitti, who took over for Capone. As the repeal of Prohi-

bition reduced the income opportunities of the Chicago mob, Nitti looked toward extortion as a source of income.

With the placement of key personnel, Nitti's organization gained control of the International Alliance of Theatrical Stage Employees and Motion Picture Operators (IATSE). Monies were extorted from major operators in the motion picture industry, including Louis Mayer and the Warner brothers. In 1943, Nitti and others were charged with extorting over \$1 million from motion-picture operators, and one day after the indictments were issued, Nitti committed suicide, allegedly being despondent over a possible return to prison.

### SPECIFIC TYPOLOGIES

*Individual(s) on individual.* This case type involves individual attempting to extort or blackmail other individuals who are not necessarily public figures. Prior cases have included: a tabloid news editor threatening to report (falsely) that a former police detective's mother had committed suicide if the detective did not give him confidential information on the Jon Benet Ramsey investigation. Rap music personality Mystikal was charged with extortion of a female acquaintance by demanding she perform certain sexual favors in exchange for not having her arrested on an embezzlement charge.

Other examples include anonymous bidders on eBay.com who have demanded extortion payments from other bidders to drop out of the bidding process and not raise the price. A multi-count criminal indictment against Teamsters Local 390 (stevedores) included extortion charges alleging that rank-and-file members were required to make payments to union officials to secure not only employment, but work in certain lucrative locations.

In 2001, the former bodyguard of singer LeAnn Rimes was arrested for attempted extortion, demanding \$2 million from her in exchange for the return of pictures and videotapes, and a promise not to reveal confidential information to tabloid publications.

In May 2001, management of a Somerset, New Jersey, construction company was charged with extortion of its workers as management, in an attempt to circumvent prevailing-rate laws, required workers to kickback part of their salaries to management under the threat of termination if the kickbacks were not paid.

*Individual(s) on public figure/politician.* Numerous cases of this type have been noted in the press, with some involving blackmail, demanding money in exchange for withholding information. Recent publicized cases include: A woman claiming to be the illegitimate daughter of television personality Bill Cosby demanding \$40 million to not sell her story to the news media. A person identified as the paramour of basketball player Michael Jordan demanded \$5 million to keep their relationship from the press.

In August 2003, an individual demanded \$25,000 for the return of \$250,000 of jewelry stolen during a baggage handling incident at New York's JFK Airport. Other examples include a photographer demanding \$3.3 million from actress Cameron Diaz in exchange for the return of some photographs and videotapes of her in an earlier private modeling session.

In March 2003, the U.S. Attorney's office in Miami obtained criminal indictments against 74 owners and operators of Florida household-moving companies, alleging their extortion by adding fraudulent additional moving charges once the furniture was loaded, and refusing to release the shipment until the additional fees were paid. In January 2003 a Rockville, Maryland woman extorted money from persons wanting home repairs; she would identify a victim through her employment at a flooring company, offering to do the job for less, but did no work after accepting money, and once the victim began to complain, physical violence was threatened against the victim and his family.

*Individual(s) on corporation.* These cases involve person attempting to secure something of value from companies by a variety of claims, including: In January 2003, two men demanded a substantial amount of money from the Van Gogh Museum of Amsterdam, the Netherlands, for the return of two early Van Gogh paintings that had been stolen from the museum. A New York City stock analyst threatened to release possibly damaging financial information against a Canadian company official if payments were not made and, after payments were originally refused, he "leaked" part of the information to a local paper and reiterated his demands.

A computer hacker, who identified himself as Maxus, demanded \$100,000 from an online CD company in exchange for not releasing the names and credit card numbers of 350,000 customers he had obtained from the company website. A person

demanding an extortion payment of \$1 million from a computer software company under the threat of posting installation instructions for the company's product that would negate the need to purchase the product from the company. In 2000, a \$200,000 extortion payment was demanded from media mogul Michael Bloomberg, under the threat of public disclosure of security breaches in the company's financial transactions computer system, as verified by a copy of Bloomberg's corporate I.D. sent with the demand. In January 2003, a Vermont man was indicted for the attempted extortion of a local hotel, by offering that in exchange for \$50,000 he would not divulge information to the local press concerning the illegal disposal of asbestos and lead paint on the hotel property (the focus of a local criminal investigation). A serial extortionist threatened a number of banks and retail stores in western Pennsylvania in 2000 by reporting the placement of an explosive device in their businesses which would be detonated if a cash payment was not made.

*Individual(s) on governmental agency.* These cases involve the extortion of governmental bodies, often concerning the threat of fraudulent litigation. Examples of such cases include: A Florida doctor and his real-estate adviser were convicted of the attempted extortion of Marion County by attempting to reach a cash payment in exchange for dropping a civil suit, a suit that was allegedly fraudulent in nature. In March 2003, police and rescue personnel (working with local "gangsters") blocked a rescue boat from delivering emergency supplies to a cyclone-stricken island until extortion payments were made.

*Politician on individual.* These cases involve elected or appointed political officials who use their authority to extort monies or other items of value from individuals, often in return for assistance in obtaining contracts. Examples of these cases include: The mayor of Bridgeport, Connecticut, was convicted of 16 criminal counts including extortion for obtaining over \$500,000 of benefits (cash, expensive wines, designer clothing, and home improvements) from business associates in return for steering city contracts worth millions of dollars to them and their associates.

*Politician on corporation.* These cases involve elected or appointed political officials who use their authority to extort monies or other items of value from companies, often in return for assistance in obtaining municipal contracts. Examples of these

cases include: New York City Councilman Angel Rodriguez was indicted in 2002 for extorting a real-estate developer, promising to support an upcoming multi-million dollar waterfront development in exchange for \$50,000 cash and the sale of three pieces of real estate at below market price (three properties valued at \$1.5 million to be sold for \$1 million; the day after the contracts for these properties were signed, Rodriguez supported the development and the full council approved the project).

In October 2002, Wisconsin state Senate Majority leader Chuck Chvala was charged with 20 felonies, including extortion, in a 67-page criminal indictment that noted multiple allegations of extortive transaction; two \$500 campaign contributions were requested from a historical society lobbyist for a friendly vote, a \$7,500 contribution was required from the Wisconsin Realtors Association before a state senate vote on licensing home inspectors would be scheduled, a wholesale beer lobbyist was fired after refusing to pay a \$1,500 campaign contribution.

*Labor relations.* These cases specifically involve the operations of labor unions and often involve the following actions, usually accompanied by the threat of force or actual force: Demand of payoffs to union representatives in violations of labor laws to achieve certain concessions, solicitation of donations to remove pickets, and as noted in the August 2000 Federal Bureau of Investigation (FBI) and U.S. Labor Department's investigation into allegations that three United Auto Workers members extorted \$200,000 and jobs for relatives to end an 87-day strike at a General Motors plant after intentionally prolonging the strike to procure the money and job offers. Other extortion cases of this type involve sham fees which labor unions are not entitled to; extorting payments from employees for various services (already guaranteed under labor contracts such as health coverage); employer payments for labor consulting to establish bogus "sweetheart unions"; payments demanded for unwanted, excessive, and nonexistent workers; and extortive demands made upon nonunion companies to vacate the marketplace.

*Law enforcement personnel on individual.* These cases involve the extortion of individuals or criminal organizations by police officers who used their police powers either to grant specific favors or to use police resources to gain information. Actual cases include: A Washington, D.C., police lieu-

tenant was arrested for using police computers to ascertain the identities of patrons of the Follies Theater, a bar frequented by homosexuals, by running license plates of vehicles parked there and, after identifying married patrons, demanding money to not inform spouses or employers. In June 2003, three Canton, Mississippi police officers were arrested for offering to arrange for the dismissal of felony charges in exchange for \$6,000.

Local police in Federal Way, Washington, offered to “fix” a woman’s shoplifting arrest (\$34 from Wal-Mart) in exchange for sexual favors. In early 2003, the chief and three officers of the Camden, New Jersey, police department admitted to extorting “thousands” of dollars from persons involved in illegal activities (\$130,000 paid by one madam to prevent the arrests of prostitutes working for her, bars selling alcohol after hours, and allowing an amusement company with Cuban mob ties to place illegal video-gambling machines in bars and other businesses), and persons seeking to obtain or keep city contracts (towing companies were required to pay “fees” to police officers to get tow calls for vehicles disabled in accidents).

In February 2003, the former Donna, Texas, police chief was convicted of multiple criminal charges including extortion relating to demanding payments from drug smugglers to escort marijuana shipments through city limits. In 1996, six members of the nine-person Ford Heights, Illinois, police department were arrested on criminal charges, including extortion related to demanding payments for protection of drug sales territories, the sale of advance information on police raids, and “forcing” out other drug dealers who refused to pay.

*Organized crime operation on individual.* These cases involve money or objects of value from individuals in exchange for either prevention of certain acts or for the non-disclosure of specific information. Specific cases include: In August 2003, local “gangsters” threatened the safety of British soccer sensation Wayne Rooney if a percentage of his earnings was not relinquished to the crime group. Both law enforcement and sporting sources have acknowledged allegations of Russian Mafia extortion of one-third of the approximately 50 former-Soviet hockey players in the National Hockey League (NHL), with one player being extorted for six-figure payments to “protect” his family in Russia; the protection payment was needed after several acts of property damage occurred. In 2003, organized-

crime family members were found guilty of attempting to extort \$3 million from Hollywood action hero Steven Seagal, who originally refused to testify out of fear of retaliation, but was faced with contempt charges if he did not. Concerning the Seagal case, another organized-crime member was charged with threatening a *Los Angeles Times* reporter who broke the story originally; she was approached by a man with a gun who told her to “stop;” her car windshield was smashed, a dead fish with a long-stemmed rose was left on her car.

In 2002, members of the Indian mafia attempted to extort Bollywood (India’s version of Hollywood in Bombay) film star Hrithik Roshan, one of many attempts by the Indian underworld to extort actors, actresses, and producers. The Yakuza (Japanese organized crime operations) utilized extortion against owners of small properties to sell to developers so that large land deals could be arranged; in this practice (*jiage*) developers pay the Yakuza three percent of the land’s value (which due to inflated land values can often cause fees to be in the high six-figures).

*Organized-crime operation on corporation.* These cases involve organized-crime groups exerting pressures on companies to obtain something of value, often associated with the construction industry. Examples of these cases include: In 1998, three men with ties to the Gambino and Genovese crime families of New York were convicted of extortion by threatening labor unrest and economic injury to a contractor on the Newark Airport monorail project; the contractor was told to put men on the payroll even though they would not report to work (at one point one “ghost worker” was taken off the payroll and labor unrest occurred until the “worker” was reinstated and given back pay). In 2002, 27 members of organized-crime families were indicted for extorting payments (said to be approximately \$10,000 per night) from Long Island, New York, restaurants.

In 1996, 17 members of the Detroit, Michigan, organized-crime families were indicted for extorting payments from bookies and operators of illegal lotteries, persons who would be likely not to report the extortion attempts to local law enforcement. In February 2002, 26 bosses and members of New York organized-crime families were charged in a 137-count indictment including multiple counts of extortion; the indictment alleged that over \$6 million in wages and benefits were illegally obtained

over an 11-year period (with money being obtained from “no-show” workers. One fictitious worker, Mattlynn, received more than 1,400 checks totaling more than \$1.5 million. Contractors who did not hire members of a certain local were threatened with labor unrest if members were not hired and paid a premium rate.

In May 2002, 14 members of the Laborers’ International Union of North America Local 91 were arrested for extortive tactics against area contractors, workers, and developers, including beatings, assaults, bombings, and a \$100,000 vandalism incident (one taped conversation included threats of rape against family members, specifically juveniles). In October 2002, two officers of Local 81 of the International Longshoreman’s Association were arrested for threatening to kill the owner of a Rhode Island scrap-metal company, an elected state representative was present at the meeting where the threat was issued and recorded, but he was not charged.

The Yakuza in Japan committed various extortion operations, with some taking advantage of Japanese law which gives building occupants tremendous rights. *Senyu-ya* (occupation specialists) Yakuza members will illegally occupy a building before its upcoming sale for one of two purposes: to extort payment from the owner to vacate the property to allow the sale to proceed, and extort protection payments until the sales is finalized. If the owner does not pay, they stay in the building causing the price to plummet.

Additionally, the Yakuza take advantage of some Japanese companies’ desires to avoid confrontation and bad public relations by committing *sokaiya*, corporate extortion, by threatening to appear at board meetings to disrupt business. The extortion is halted either by cash or stock payments. Yakuza operations also use extortion in their debt-cutting/loan-collecting services (*songiri-ya*) in which loan payments are “recovered” by the Yakuza, charging their client 3 percent for “collecting” the debt and, the person collected from a 5 percent fee for getting the debt holder to accept a smaller amount on the loan (threat of force or force is often utilized against one or both parties);

*Ethnic extortion operations.* These are a subclassification of organized-crime extortion but identified by the ethnic specificity of both parties. Due either to a fear of law enforcement in general or a belief that local law enforcement would not be able to re-

solve the situation, members of some ethnic groups do not report these extortion attempts to the police. Cases of this type would include: Smugglers of illegal aliens across the U.S.-Mexico border who demand additional payments from their customers after they cross the border—detaining the undocumented aliens until their family members send more funds.

Asian street gangs often require local (Asian) businesses to pay protection money to the gangs to prevent acts of violence and, as noted in New York City’s Chinatown, they have made businesses install gang-owned blackjack and video-poker machines in their operations (similar activities have been noted by Chinese Tong, Vietnamese, Korean, and Russian gangs). A Dominican street gang, C&C, in the Bronx, New York City, demanded money from any group wishing to conduct illegal-drug sales in the Mott Haven section (mostly occupied by immigrants from the Dominican Republic), and anyone who refused to make payments was robbed, beaten, and sometimes murdered.

Indian crime gangs extort *hafta* payments, from Indian business owners (jewelry stores, restaurants, fast-food operations.) with the amount of *hafta* being a set payment according to the profit made by the business, with refusal to pay usually resulting in personal injuries. An Israeli organized crime operation in Los Angeles, California extorted protection money from elderly Jewish business-owners in the predominantly Jewish community of Fairfax and, in some cases, extorted partial ownership in businesses to run “bust-out” (order large sums of merchandise and then declare bankruptcy) schemes. In March 2003, members of the Philadelphia KGB, a gang of Russian émigrés, were charged with extortion, specifically using a soldering iron on at least one victim.

As evidenced by all these examples, extortion is rampant in the worlds of white-collar, corporate, and organized crime, often crossing into violent street crime.

#### SEE ALSO

bribery; Capone, Alphonse; fear of crime; organized crime; Japan; India; Central America; South America.

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## Exxon Valdez

THE CRASH of the Exxon Valdez in the waters off the coast of Alaska represents the worst oil spill in U.S. history, to date in the spring of 2004. On March 24, 1989, the Valdez tanker collided with Bligh Reef in the Valdez Narrows and spilled over 11 million gallons of crude oil into the waters of Prince William Sound.

Scheduled for a five-day trip from Valdez, Alaska, to Long Beach, California, the tanker was loaded with 1,264,164 barrels of North Slope crude. Just hours before the departure of the Exxon Valdez, its captain Joseph Hazelwood had been drinking a round or two of vodka. This factor was attributed as the primary cause of the accident. During the voyage, Hazelwood's speech was slurred while in radio contact with Coast Guard officials and, at one point, he mistakenly identified his vessel as the Exxon Baton Rouge. In addition, he made several questionable judgments regarding the course of the tanker.

Due to concerns over icebergs in the sound, Hazelwood had to make a decision regarding the direction of the Valdez. Instead of slowing down and waiting for the ice to move or have the ship work slowly through the ice, Hazelwood choose to turn the tanker and enter a gap between the ice and the Bligh Reef. The gap in this area was only one-tenth of a mile wide, almost the width of the tanker itself. This meant there was little room for error. Hazelwood also ordered that the tanker's speed be increased and the ship be placed on automatic pilot. Both commands were highly unusual. Normally, ships reduce their speed when they encounter ice in

order to minimize impact and allow for adjustments. Furthermore, the use of the automatic pilot was rare under such conditions because of the need to make changes in the ship's course. Another questionable decision by Hazelwood was leaving only one officer in charge of maneuvering the Exxon Valdez through the gap.

This lone officer was not given clear instructions regarding a course to follow nor an exact chart of the tanker's position. Shortly after Hazelwood left the officer alone, the Exxon Valdez ran aground on Bligh Reef and began leaking tremendous amounts of oil. For 15 minutes, Hazelwood attempted to force the tanker ahead but eventually the smell of oil in the air and control room gauges, that confirmed significant losses of oil, forced the crew to stop and wait for Coast Guard assistance. While the cause of the crash and spill was attributable to the officer being unable to properly maneuver the tanker, other factors played a major role. First, several of Hazelwood's decisions and judgments were highly questionable due in part to his impaired or intoxicated state. Second, the Exxon company reduced the Valdez crew, meaning that many of the members were excessively overworked and fatigued. Finally, Exxon did not have a proper recovery plan in place that could effectively deal with such a disaster.

The effects of the oil spill were tremendous on the surrounding communities. The loss of marine life, wildlife, and natural resources was abundant. The disaster happened at a time when fish and other marine organisms were beginning their reproductive cycles, and the large amounts of oil devastated the development and threatened the existence of many aquatic species and mammals. Over 200,000 seabirds were lost as well as thousands of sea otters and hundreds of other wildlife, including deer and eagles.

The economy of the surrounding communities was also significantly affected. For many families, the multimillion-dollar commercial fishery industry was dramatically altered or completely destroyed. In 1989, one of the primary economic resources, salmon fishing, was completely closed. While Exxon agreed to help with the recovery process, it remained slow. Some 15 years later, several of the animals and species in Prince William Sound had not fully recovered. Some shellfish remained contaminated and unsuitable for human consumption. The herring population collapsed in

1993 and had not recovered 10 years later. In 1992 and 1993, pink salmon runs failed and in 1994 they were severely depressed. In some instances, animals have almost left the region completely. Certain species of seals, sea otters, ducks, and killer whales can no longer be found in the region's waters. The majority of the animals and species, however, have very gradually recovered, yet millions of gallons of oil still exist in the mud and sand surrounding the Prince William Sound area.

In the aftermath of the disaster, Exxon paid billions of dollars in criminal and civil fines. The company paid \$900 million to the Exxon Valdez Trustee Council in 1991 to oversee the restoration of ecosystems damaged by the spill. This civil suit was filed under the Clean Water Act and the Comprehensive Environmental Response, Compensation, and Liability Act and the money awarded represented the largest recovery in U.S. history.

Also in 1991, Exxon pled guilty to a criminal charge and paid a \$100 million fine. In 1994, a federal court ordered Exxon to pay \$5 billion in punitive damages to help Alaskans harmed by the oil spills. The court stated that Exxon acted recklessly by allowing Hazelwood to command the *Valdez* tanker. Hazelwood was fired by Exxon and lost his

license to captain a ship. In addition, he faced criminal charges for leaving command of the ship to an uncertified officer and was convicted of negligent discharge of oil. He was sentenced to serve 200 hours per year of community service until 2004.

#### SEE ALSO

water pollution; Clean Water Act; negligence; United States; Environmental Protection Agency.

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# F

## Fair Housing Act

CONTAINED WITHIN the Civil Rights Act of 1968, the Fair Housing Act (Title VIII) bans potential discrimination in the real estate market. Most housing types are covered by the Fair Housing Act, except for certain exemptions by the act, which include buildings occupied by the owner with fewer than four units, single-family homes rented or sold without the assistance of a realtor, and housing administered or operated by private clubs. Enforcement of the Fair Housing Act is the responsibility of the U.S. Department of Housing and Urban Development (HUD).

The Fair Housing Act bans a number of discriminatory real estate actions based on race, national origin, religion, sex, familial status, or disabilities. No one may refuse to rent or sell housing, refuse to negotiate, take property off the market, deny the availability of a property, establish different guideline or fees for the sale or rental, provide different services or facilities, force owners to sell or rent, or deny listing of a sale or rental based on discriminatory criteria. When dealing with mortgages, no one may deny a mortgage loan, refuse to provide loan details, set different mortgage terms, or appraise a property differently. Lastly, the Fair Housing Act prohibits one from threatening or intimidating a person who is exercising his or her

fair housing rights, or from advertising or making statements which portray a preference in a real estate transaction based on discriminatory criteria.

If someone has a disability, she receives additional protection of her fair housing rights. A landlord may not refuse any reasonable modifications to the property if it allows a potential resident to use the housing, and landlords must make reasonable changes to housing policies or practices which make



*The Fair Housing Act regulated against discrimination based on family status or disability, among other criteria.*

it more accessible to residents with disabilities. For example, an apartment complex with a policy that bans pets must allow a blind resident to have a seeing-eye dog.

The Fair Housing Act established a timeframe which set requirements for housing complexes constructed after March 13, 1991. In all buildings with an elevator and more than four units, public areas must be accessible by disabled individuals, halls and doors must be suitable for wheelchair use, and all units must have accessible entrances, light switches, electrical outlets, and thermostats. Also, bathroom walls must be reinforced to allow for the potential installation of assistance bars.

Familial status is a major discriminatory criterion which is targeted by the Fair Housing Act. Unless a residential complex or community is qualified and registered for senior citizens only, owners or realtors may not discriminate against families with one or more children under the age of 18. In order for a facility to become registered as elderly housing, the property must only be occupied by people who are 62 or older or 80 percent of the residents are 55 or over, and the elderly status may be reviewed by the HUD secretary.

If a person is aware of the rights guaranteed by the Fair Housing Act and believes that they have been violated, complaints may be filed with HUD by letter or by telephone. After providing the necessary contact information and an account of the alleged discrimination, HUD will request a response from the alleged violator. After receiving the response, the claim may or may not be investigated further. Meanwhile, HUD will attempt to reach a conciliation agreement between the two parties which ameliorates the situation to the satisfaction on those involved.

If HUD believes that a person's rights have been violated and a conciliatory agreement cannot be reached, the person who submitted the claim and the violator will receive notification of an administrative hearing at no cost, which may be turned over to the federal court system if either party requests it. Potential outcomes of a hearing or a trial, where someone is found to be in violation, include compensation for damages, which takes humiliation and suffering into account or a ruling which requires that the housing be available.

Civil penalties payable to the federal government of up to \$10,000 for the first violation and \$50,000 for the third violation in seven years may

also be assessed, as well as payment of the attorney's fees.

#### SEE ALSO

racial discrimination; gender discrimination.

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## False Claims Act

BACKED BY PRESIDENT Abraham Lincoln, the False Claims Act (FCA) was enacted in 1863 and amended by Congress in 1986 to increase its implementation. The act is designed to deter fraud against the federal government by authorizing private citizens, known as *qui tam* relators, to file charges against any party attempting to collect payment from the government through fraudulent claims. The FCA covers a wide array of issues and requires only that a perpetrator did or would cause financial loss to the United States by "knowingly" committing fraud, whether through deliberate ignorance, disregard for proper practices, or outright falsification of claims. Examples of lawsuits filed under the FCA include: defense contractor overcharges, misrepresentation of Medicare healthcare services, and misuse of federal grant money from organizations such as the National Institutes of Health.

In addition to making fraudulent claims against the government punishable by both civil and criminal penalties, the FCA makes filing an anti-fraud lawsuit a potentially lucrative endeavor for any individual with direct knowledge of alleged fraud against the United States. The total recovery from each liable defendant is a fine of \$5,000 to \$10,000 for every violation plus three times compensatory damages on all overcharges.

On top of whistle-blower protection and relief, the *qui tam* relator is guaranteed up to 25 percent of the settlement in cases where the government inter-

venes and 25 to 30 percent in all other cases. From 1986 through 1996, FCA recoveries amounted to over \$1.13 billion, with private relators receiving over \$200 million in rewards. Around 1996, the emphasis in claims switched from defense contracting to healthcare fraud. This shift in focus resulted in a peak of 535 lawsuits filed in 1997 and monetary recoveries reaching \$1.2 billion for 2001.

By 2004, the trend in FCA claims shifted once again. The growing complexity of healthcare related cases has led to a decline in healthcare fraud lawsuits, but has opened the door to a new area of claims: research institutions. Under the terms of the FCA, research institutions can be held accountable for the actions of individual employees when these actions involve improprieties in the grant-reimbursement process, scientific misconduct, and failure to comply with rules regarding human research subjects. With settlements such as the \$32 million paid by the University of Minnesota for misappropriation and misrepresentation of grant money, it is likely that FCA cases in this area will continue to escalate.

Unfortunately, several problems emerged with the increased incentives for private *qui tam* relators to file FCA suits. For one, the FCA reward provisions virtually encourage relators to allow misbilling practices to grow to considerable dollar amounts before filing an FCA claim. Furthermore, the positive encouragement given to voluntary corporate audit and compliance programs in recent years is offset by the risk associated with generating information and reports that could fall into the hands of a money-hungry relator.

Finally, despite FCA protection, a reputation as a whistleblower is likely to permanently impair an individual's career prospects in a particular industry.

#### SEE ALSO

whistleblowers; government contract fraud; government procurement fraud; healthcare fraud; Justice, Department of.

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## fear of crime

MANY STUDIES CONCLUSIVELY demonstrate that, for Americans, fear of crime is worse than crime itself. A person's risk of becoming a victim of serious street crime in the United States is relatively low. For example, only about 8 percent of Americans were victimized in 2002, mostly by property crimes, and only 0.006 percent of Americans were murdered. Yet, according to several studies, more than half of Americans report being concerned with or afraid of crime.

Fear can be understood as an emotion, a feeling of impending harm to one's well-being. A dictionary definition of fear would include an unpleasant and strong emotion caused by anticipation or awareness of danger, anxious concern, and anxiety or loss of courage caused by environmental circumstances. Fear of crime can be understood as being afraid, anxious, or concerned about becoming the victim of a criminal act, whether the risk of actually becoming a victim is real or imagined. Fear of crime is distinguishable from perception of crime risk. Whereas the former refers to an emotional state, the latter refers to more rational, evaluative judgment; an assessment of the likelihood that harm to a person's well-being from a criminal act will actually occur based on the presence or absence of certain environmental conditions.

#### MEASUREMENT AND FINDINGS

Fear of crime is typically measured through telephone surveys and written questionnaires. Subjects are asked about how safe they feel at home when alone, whether they feel safe when walking in their neighborhoods or on local streets, and how afraid they are of particular crimes.

According to hundreds of studies, fear of crime often emanates from actual criminal victimization, particularly when the victimization is perceived by the victim as serious. Victims of crime often report

higher levels of fear than non-victims. Studies show that being afraid of any physical harm predicts fear of crime, and that being afraid of certain types of crimes such as random violence, gun violence, and gang violence, predict fear of crime reasonably well.

Fear of crime also arises from exposure to accounts of crime in the media, which is not surprising given that most media crime reports focus on violent, random, and even bizarre crimes. Fear of crime also can stem from hearing about victimizations of friends and family members; this is created by what is called "vicarious victimization." Finally, fear of crime can also be preceded by a perception of crime risk, that is, a person perceives she will actually be a victim of crime and thus becomes afraid, but the emotional state of fear does not require a rational, evaluative judgment that crime victimization will actually occur. For example, a person may become afraid of being a victim of a mugging while walking on an isolated and dark stretch of desert road, even though being alone means a person cannot become a crime victim.

Fear of crime is generally higher among women than men, and among the elderly than among the young. This holds true even though the relative risk of criminal victimization for women and older people is less than that for men and younger people. Fear of crime is also thought to be higher in people who earn low incomes, who attain low educational achievement, and in people who consider themselves to be relatively powerless.

### ALONE AND AFRAID

Fear of crime has also been found to be higher in people who report low levels of friendship networks, people who live alone, and people who believe they make particularly suitable targets for victimization. Fear of crime is found to increase in environmental conditions that are thought to be conducive to criminality (for example, dangerous or dark, isolated places) and in run-down areas where incivilities and social disorganization are higher. It has also been related to attributing evil intent to others (for example, based on racial stereotypes). People who fear strangers and minorities are more likely to fear crime.

People with less active lifestyles and people who watch large amounts of television are generally thought to be more afraid of crime, as well. Public opinion polls show that public concern over crime

peaks after coverage of major criminal acts. For example, concern over violent street crime peaked in 1994 after coverage of random violence and rioting in Los Angeles, California.

Public concern over terrorism increased in 2002 and 2003 along with the coverage of attacks against the United States and the War on Terrorism. That random violence in the 1994 riots and terrorism on American soil after 2001 were rare was not relevant for the levels of fear. Fear of crime is also thought to be higher among American citizens than citizens of other countries, even though generally U.S. citizens suffer no more criminal victimization than they do.

Virtually all studies of fear of crime focus on fear of certain types of street crime. Rarely has fear of white-collar and corporate crime been examined. Many studies have found that most Americans, even students of criminology and criminal justice, are relatively unaware of their risk of victimization from white-collar and corporate criminality. When people are unaware of such crimes, there is no reason to expect that these acts will be feared, even though the physical and financial harms caused by such acts dwarf the harms caused by all street crimes combined.

### SEE ALSO

crime seriousness; consequences of white-collar crime; extortion.

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## Federal Deposit Insurance Corporation

THE FEDERAL DEPOSIT Insurance Corporation (FDIC) is an independent agency of the federal government created in 1933 to provide insurance protection for depositors in the event of bank failure. Since 1933, the FDIC has responded to thousands of bank failures, and its insurance protection has been expanded to include accounts in savings and loan associations. All insured depositors of failed banks and thrifts have been protected up to \$100,000 by the FDIC. The FDIC is also the federal bank regulator responsible for supervising certain savings banks and state-chartered banks that are not members of the Federal Reserve System.

As a regulator, the FDIC strives to prevent bank failures by monitoring the industry's performance and enforcing regulations intended to make sure financial institutions operate in a safe and sound manner. Banking, however, is a competitive business. Banks fail, and when they do, the FDIC uses money from the two insurance funds, the Bank Insurance Fund (BIF) and Savings Insurance Fund (SAIF) to promptly reimburse insured depositors. Banks and thrifts must pay the FDIC money four times a year to keep being insured. This money is collected and deposited into the BIF and SAIF. The amount of money each bank pays depends on how much the bank has in deposits and also how much money is already in BIF and SAIF.

To be insured by the FDIC, a bank must prove it is being run profitably and fairly. The FDIC visits banks on a regular basis, at least once per year, to make sure they are following the regulations. During the on-site visit, the FDIC employee, often called an examiner, can delve into the files to assess the quality of particular loans or to look for evidence of fraud or insider abuse.

FDIC examiners often uncover occurrences of insider fraud. Insider fraud has accounted for over one-half of all bank fraud and embezzlement cases closed by the FBI during the past several years. Insiders are in a position of trust and can abuse that trust for their own personal benefit. Insider abuses include failure to disclose their financial or personal interest in a business borrowing from the bank; diverting assets and income for their own use; misuse of position by approving questionable transactions for relatives, friends or business associates; abuse of

expense accounts; acceptance of bribes and gratuities; and other questionable dealings related to their positions at the institutions.

The FDIC and other federal banking regulators can correct and punish unsafe and unsound, or illegal practices and seek to rehabilitate troubled banks. The FDIC has a wide variety of enforcement powers, ranging from the informal written agreement to the more formal powers, such as the cease-and-desist order. The FDIC has the ultimate enforcement authority over banks and thrifts in the power to terminate insurance, as well as close an insolvent bank, one that lacks the money to pay depositors.

### SEE ALSO

bank fraud; embezzlement; savings and loan fraud; accounting fraud.

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## federal gambling regulation

GAMBLING, in one form or another, has been around since the dawn of mankind. Gambling is an agreement between two or more individuals; it involves a game of chance where the winner becomes the owner of the loser's property. The U.S. government derives its power to enforce gambling regulations by Article 1 of the U.S. Constitution. The Commerce Clause grants "Congress the power to regulate commerce with foreign nations and among the several states."

This broad power has been used by Congress to abolish slavery, combat racketeering and organized crime, and desegregate the South. The U.S. Supreme Court has typically upheld these landmark decisions. In the early American Colonies, gambling was seen as an evil sin. This is understandable since many of the colonists were strict religion-

ists with strong social codes against sin and vice. There have been numerous valleys and peaks in the tolerance of gambling in the United States. Andrew Jackson believed betting was a sin.

After the Civil War, especially in the American West, gambling gained popularity. However by the 1890s, gambling was outlawed in most areas of the United States. Nevada legalized casino gambling in 1931. This monopoly on gambling stayed in place until New Hampshire introduced its state lottery in 1963. Since then, a majority of states have instituted some form of gaming as a rich supplement to state income.

In the United States gambling has been regulated by each individual state. Some states such as Alabama do not allow any type of gambling at all, while other states such as Nevada, New Jersey, and Mississippi permit it in a variety of forms. In the late 1970s and early 1980s, several Native American tribes wanted to open gambling establishments on their tribal lands, as tribal elders searched for ways to relieve the desperate, ongoing poverty of their tribes.

While the tribes stated sovereignty in the affairs that dealt with their land and people, Congress did not agree. In 1988, Congress passed the Indian Gaming Regulatory Act. This act states that tribes may participate in ritual gaming, card games, and bingo with the guidance of the National Indian Gaming Commission. Tribes may open and operate casinos if they have an agreement with the state in which their land is located. Gambling laws in America are enacted and enforced in the classic Federalist style.

The federal government tends to take the *laissez-faire* (hands off) approach to these matters, and allows states to enact laws they deem necessary and only intervenes when needed or asked to by the states.

#### SEE ALSO

organized crime; Racketeering Influenced Corrupt Organizations Act; gambling and lotteries.

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## Federal Trade Commission

THE FEDERAL Trade Commission (FTC) was enacted under the Federal Trade Commission Act of 1914, and was created in 1915. The FTC provides regulatory enforcement of rules and regulations designed to maintain fair and open competition in the marketplace. While the banking and transportation industries are regulated by other agencies, the FTC is responsible for enforcing rules and regulations for many other industry groups, including those that may be related to banking and transportation.

In addition to enforcement of the FTC Act, the FTC is responsible for enforcing laws created by other acts, such as the Wheeler-Lea Act of 1938 and the Robinson-Patman Act of 1936. The FTC does not possess criminal law enforcement powers, but does have civil and regulatory authorities that are enforceable through the federal court system. Among the actions available to the FTC are consent decrees between the commission and businesses. Consent decrees are agreements between the parties in which the offending business does not admit fault, but agrees to never engage in the behavior.

The FTC can also issue cease-and-desist orders, ordering businesses to change trade practices under the possibility of penalties for failure to comply. The FTC can also make a criminal referral to the U.S. Department of Justice in those instances in which a business fails to comply with a cease and desist order or refuses to enter into a consent agreement, or in which the FTC finds that the case is so severe that criminal action is warranted.

The FTC is divided into several bureaus, each of which is responsible for various activities within the commission. The Bureau of Consumer Protection comprises six divisions. The Advertising Practices Division deals with truth-in-advertising practices such as deceptive or unfair advertising. Such violations may include advertising a product at a certain price, while refusing to honor that price at the store. The Enforcement Division civilly prosecutes such cases and enforces other consumer protection laws.

The Financial Practices Division develops policies and enforces laws concerning the Truth-in-Lending Act, which requires lenders to follow certain rules and guidelines in issuing credit. For example, the FTC might get involved in cases where lending institutions automatically force minority borrowers to borrow money at subprime rates regardless of their credit history. Subprime rates are

given to borrowers at higher interest rates than are available to other borrowers.

The Marketing Practices Division enforces consumer protection laws dealing with such issues as deceptive telemarketers, pyramid schemes, and internet scams. The Planning and Information Division assists consumers in getting information they need, as well as assisting FTC attorneys and other law enforcement agencies in protecting consumers' rights. The Consumer and Business Education Program develops advertising and education program to educate consumers and businesses about their respective rights.

## LAW ENFORCEMENT

The Bureau of Competition enforces antitrust laws and deals with the enforcement of merger and acquisitions, nonmerger enforcement, and research and policy studies. The FTC Act, along with the Sherman Antitrust Act of 1890, the Clayton Antitrust Act of 1914, and other acts, mandates the FTC and other agencies to maintain a competitive marketplace free of monopolies and other trade restraints.

There are two basic types of mergers. Horizontal mergers occur when a business purchases a competitor, thus reducing the number of competitors in the marketplace, and possibly resulting in an unlawful monopoly. Vertical mergers occur when a business purchases a collateral business such as a supplier or store that sells its products. Nonmerger enforcement deals with such anticompetitive acts as price fixing, boycotts, and illegal ethics codes. Research and Policy Studies is a part of the Bureau of Competition and produces reports for Congress concerning issues of consumer protection that are important to the public, and analyzes policy proposals for the FTC.

The Bureau of Economics help the FTC evaluate the possible influence of its enforcement actions on individuals, businesses, and the marketplace. The bureau also analyzes the market and its operation and produces studies of legislative actions and regulations.

## SEE ALSO

Federal Trade Commission Act; Sherman Antitrust Act; Clayton Antitrust Act; Robinson-Patman Act; monopoly; Truth-in-Lending Act; advertising fraud; price fixing; internet fraud.

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## Federal Trade Commission Act

THE FEDERAL Trade Commission Act of 1914 (FTCA) was passed to create the Federal Trade Commission (FTC), and to give the U.S. government a full salvo of ammunition to use against anticompetitive market behavior, as well as other forms of unlawful behaviors in the marketplace. Specifically, the FTCA provided for regulatory enforcement against individuals, corporations, and organizations that violated the Sherman Antitrust act of 1890, and the Clayton Antitrust Act of 1914.

In addition, the FTCA barred the use of deceptive or false advertising by individual, corporations, and organizations. Deceptive advertising occurs when an individual, corporation, or organization knowingly advertises a product or service, which does not exist, or is not what is truly advertised. One type of deceptive advertising is known as bait-and-switch advertising. In bait-and-switch advertising, an advertiser markets a product to draw a customer to their establishment, at which time a salesperson will either tell the consumer that the advertised product is not available, or that there is a better quality product available at a higher price. The FTCA allowed for bringing a regulatory action against any individual, corporation, or organization involved in interstate commerce with the exception of banking institutions, the transportation industry, and agricultural cooperatives.

The FTCA requires a lesser standard of proof than do the Sherman and Clayton Acts. Under the FTCA, the standard of proof is whether "the acts of practice causes or is likely to substantial injury to consumers which is not reasonably avoidable by consumers themselves ..." The Sherman Antitrust Act of 1890 provided for criminal penalties for interstate violations of laws pertaining to business monopolies and other market restraints, which re-

quire a beyond reasonable doubt standard of proof. Likewise, the Clayton Antitrust Act of 1914 allowed for civil action against individuals, corporations, and organizations involved in anticompetitive behavior, requiring a preponderance of the evidence standard of proof. The FTCA was meant to give extra enforcement power to the government without the long tedious process of bringing a case to trial in either a criminal case or civil action, nor requiring the stricter burdens of proof to protect consumers.

Unlike the Sherman and Clayton Acts, the FTCA allowed accused parties to enter into a consent agreement with the FTC in which the party would not admit guilt, but would agree never to engage in the behavior in the future. The FTCA also gave the FTC the power to issue cease-and-desist orders, which would be enforceable by petition to the U.S. Circuit Court of Appeals. Failure by a defendant party to act in accordance with the consent decree or cease-and-desist order can result in the party being found in contempt and subject to other actions, including criminal referral to the U.S. Department of Justice (DOJ).

Additionally, the FTC may under some circumstances either make a criminal referral to the DOJ without first engaging in a regulatory action, or engage in a civil suit against the defendant party. This may occur if the FTC believes that the behavior is so grievous as to warrant regulatory action, or if the defendant party chooses to not cooperate with the FTC.

#### SEE ALSO

Federal Trade Commission; Justice, Department of; Sherman Antitrust Act; bait-and-switch.

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## **felony**

GENERALLY, THE DESIGNATION of an offense as a felony or misdemeanor is determined by the

punishment prescribed. Thus, a felony is defined as an offense for which an offender, upon conviction, may be punished by death or by imprisonment for more than one year, and an offense is a felony so long as the statutory maximum punishment is for more than, that is, in excess of one year. Felony has been said to be crime of a graver or more atrocious nature than those crimes designated as misdemeanors.

What may be a felony in one jurisdiction may be a misdemeanor in another, and vice versa, and in some jurisdictions crimes may not be classified at all. The very concept of felony seems to have been introduced into England by the Normans. The term originally referred to a breach of faith between man and lord. The Norman word for such a breach of faith was *felony*. In England after the Norman Conquest, the most serious crimes came to be called felonies because they were considered to be breaches of the fealty owed by all people to the king as guardian of the peace of the realm. In common law, a felony was an offense punishable by forfeiture of land and goods to the crown. Thus, the term became applicable to certain specified crimes, including murder, rape, robbery, and others, which still are referred to as common-law felonies.

An appeal of felony was an ancient form of a lawsuit brought by a victim, or the heir or widow of a slain victim, against a wrongdoer to prove the commission of a felony. Appeals in the sense of suits by victims seeking punishment for their wrongdoers came before the king's court when victims formally alleged that wrongdoers acted feloniously and against the king's peace. Victims could bring appeals for any of the traditional common-law felonies, including homicide, rape, mayhem (maiming), robbery, burglary, larceny, and arson. The consequences of conviction were drastic. The usual sentence for felons after 1200 was death by hanging. The king received the value of any goods, chattels, and short-term interests in land possessed by a felon after the commission of the felony.

A mark of the ancient origin and drastic consequences of the appeal was the use of trial by battle to decide the truth or falsehood of the accusation. By 1250, defendants in most appeals could choose to defend themselves either "by my body" (waging battle with the plaintiff in a duel) or "by the country" (putting the question of a person's guilt or innocence to an inquest, a jury of 12 lawful men from the place where the alleged wrong occurred).



All litigants who lost their cases before the king's courts in this period had to pay an immurement, a small monetary penalty, for asserting their unsuccessful claims or defenses. Unsuccessful plaintiffs in appeals of felony were in much more serious trouble. *The Bracton Treatise*, written in the mid-13th century, stated that in earlier times, a false accuser suffered the same death penalty the falsely accused defendant would have suffered. In the 13th century and afterward, unsuccessful plaintiffs in appeals, including those who had admitted defeat in battle, could be sent immediately to prison until they obtained a pardon or paid a large fine to the king.

Indictment of felony was an alternative to appeal of felony, a newer method (new in the late 1200s) of starting a prosecution. The sheriff, as a king's representative, would pick 12 jurors in each locality who would swear to make presentment of all persons suspected of committing felonies or trespasses there. A presentment of felony, written up as an indictment, would put the suspected wrongdoer on trial at the king's suit, not at the suit of any individual victim.

Gradually, over the course of the 13th through 16th centuries, indictments of felony replaced victim's appeals of felony. Victims who feared trials by battle or the risk of fine or imprisonment associated with appeals of felony could seek vengeance indirectly by telling the facts to a sheriff, coroner, constable, or justice of peace. These officials were duty-bound to bring information from any source about felonies and trespasses to the jury of presentment, ancestor of our grand jury. Victims had no control over prosecutions by indictment, but they could expect that wrongdoers convicted on indictments of felony would suffer the same punishment as those convicted on appeals: death, confiscation of goods, and forfeiture of land. Confiscation of felons' goods and a year's rent from their lands were valuable rights for the crown.

In addition, by 1400, convicted felons often paid large sums to purchase pardons from the king and thereby save their lives and recover their lands. The king's interest in punishing felonies and other wrongs was more than just a financial motive. The king punished felons because every subject wanted or should want them punished; the king's peace was their peace. A felon to the king was a felon to the whole kingdom. Robbery and fighting offended the whole community, not just the individual victim.

Thus, comes the notion that a crime is against the state (society), not just the individual victim. The appeal of felony as an individual lawsuit gave way to the indictment of felony, pursued by the king (state). This is the immediate predecessor of our current notion that a crime is against the state, and the state undertakes the prosecution and punishment.

#### SEE ALSO

prosecution; sentencing guidelines; ancient mercantile crime; corporate liability.

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## fertility fraud

**CRIMES IN REPRODUCTIVE** medicine that entail embezzlement from sperm banks or the theft of human eggs and embryos—once imagined only in science-fiction or mystery novels—have become a disturbing reality. Rumors of "egg-snatching" have been intimated since the development of the in vitro fertilization (IVF) procedure.

Robert Edwards, who in 1978 was responsible for the first successful "test-tube" baby, allegedly used eggs without the consent of donors. The field of reproductive medicine has become replete with accusations of malpractice and insurance fraud, due in part, to unprecedented technological and fiscal



*Fraud or negligence can occur at any stage of the in vitro fertilization process, including in laboratory procedures.*



*Many infants born as a result of fraudulent fertilization may never know their true genetic heritage.*

growth. The estimated \$2-billion-a-year industry has outpaced regulations and legislations. Procedures for infertile couples have come under legal and professional scrutiny as bizarre scenarios have emerged involving human sperm, eggs, and embryos.

Crimes involving the misuse of sperm and eggs have occurred throughout the world. A fertility doctor in Italy faced criminal charges after he impregnated women without their consent with strangers' sperm. Speculations also abound that the doctor may have created "hundreds or thousands" of half-siblings by using sperm from only two donors. Another fertility doctor admitted that during his medical residency at Georgetown University in Washington, D.C., he used his own sperm for donations that resulted in 33 pregnancies, despite professional mandates that limit sperm donations to 10 recipients. The "egg hunt" involved a group of doctors in Massachusetts that allegedly took hundreds of eggs from women receiving medical care without fully informed consent.

Cecil Jacobson, a noted Virginia physician and medical pioneer, received national attention after reports emerged that he used his own sperm to inseminate women—without their consent. The self-proclaimed "baby maker" also used hormone treatments to convince women that they were preg-

nant only to report a few weeks later that the fetus had died. Jacobson may have fathered as many as 70 children over the course of 12 years. In 1992, he was convicted of 52 felony counts of fraud and received a five-year prison sentence.

#### FRAUD WHISTLEBLOWERS

The most widespread fertility scandal became public in mid-1995 at the University of California, Irvine's medical center. The apparent misdeeds at the Center for Reproductive Health were reported by three whistleblowers, who suffered retaliation and were paid a sizable sum as part of a confidential settlement agreement with the university. In 1993, internal auditors, who were later demoted or fired, had reported problems with insurance billings and financial irregularities to university administrators.

Primary among the many accusations was that doctors Ricardo Asch, José Balmaceda, and Sergio Stone implanted stolen eggs and misused embryos in scientific research without the consent of the "owners." Asch and Balmaceda fled the United States to South America to avoid arrest after a federal indictment was issued charging them with fraud. Stone remained in the United States and faced charges of mail fraud and tax evasion. Stone, who had no involvement in the misuse of oocyte

(cells from which a fetus develops), was convicted of mail fraud but acquitted of the other charges. Over 100 former patients, who hoped to seek financial redress for their victimization, filed civil lawsuits against the doctors and the university. The patients accused the doctors of negligence, fraud, conspiracy, and racketeering for the sale, donation, and/or misappropriation of their eggs and embryos. The university ultimately settled the patient suits at a cost of more than \$20 million.

### WHITE-COLLAR ASPECTS

Social science investigations of medical fraud are commonly done within the framework of white-collar crime. Criminologists have researched a variety of criminal actions in the medical field, such as fee-splitting, insurance fraud, and unnecessary surgery. Researchers have learned that physicians who engage in fraud have avoided scrutiny because of prestige, autonomy, and power associated with their social status (indeed, fitting Edwin H. Sutherland's classic definition of white-collar crime). Doctors working in advanced reproductive technology may foster an air of impenetrability even beyond other physicians because of the intimate nature of what they do. The intricacies and rapid changes within this specialization may encourage deviance for the sake of scientific achievement, personal glory, or fiscal fortune (hence, the bioethical challenges of human cloning).

Fraud in reproductive medicine has ranged from false advertising to faked research results. Some experts claim that patients often are subjected to extensive testing that may be unnecessary, undergo treatments that have a low chance of success, or are treated beyond the optimum years for achieving a pregnancy. Given the fiercely competitive nature of the specialty, clinics may exaggerate successful pregnancy rates or lure patients with questionable money-back guarantees. Insurance fraud may involve using inappropriate billing codes that reflect a different type of procedure that is covered by the policy, or making claims for attending physicians who were not present during the surgery. Like other white-collar crimes, most violations in reproductive medicine are difficult to detect. Proving intent is problematic. Fraud in reproductive medicine is rarely legally defined, though a few states have adopted statutes safeguarding embryos. A smattering of court decisions have delved into

cases addressing the destruction of embryos and disputes over custody of embryos. A 1978 New York district court decision awarded \$50,000 for the intentional infliction of emotional distress when a doctor destroyed a couple's incubated "pre-embryo" without prior consent.

In *York v. Jones* (1989), the first case to deal with a dispute between an IVF program and a couple over custody of a frozen embryo, the court determined that the embryo was the property of the gamete providers. After the Irvine scandal, California enacted legislation that made the intentional transfer of eggs, sperm, or embryos without consent a felony punishable by a maximum of five-year prison term and fines up to \$50,000.

### SEE ALSO

insurance fraud; unnecessary surgery; medical malpractice; differential association; Sutherland, Edwin H.

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## fiduciary fraud

**FIDUCIARY FRAUD**, a branch of white-collar crime that has witnessed rapid growth since the 1980s, involves a breach of trust committed by financial institutions such as banks and savings and loans, insurance companies, financial service companies, and pension funds. Embezzlement by lower-level employees, still the most popular form of fiduciary fraud, has been overshadowed by the misdeeds of upper-level staff who mismanage and loot their own companies.

A fiduciary, commonly a trustee, possesses powers that normally belong to another person. As such, the fiduciary bears a legal obligation to act primarily for the client's benefit in financial matters

and not for the fiduciary's own personal interest. Fiduciaries are duty-bound to always act in complete fairness and to not exert any influence or pressure, take selfish advantage, or deal with the client in such a way that it benefits the fiduciary or prejudices the client. Business shrewdness, hard bargaining, and taking advantage of the forgetfulness or negligence of the client are totally prohibited actions. Fiduciary responsibilities exist for persons other than trustees such as between solicitor and client and principal and agent.

The most publicized and most expensive type of fiduciary fraud involves savings and loan institutions. In the 1980s, savings and loan fraud cost \$200 billion in short-term losses to taxpayers with the eventual costs projected to be about \$500 billion as interest accumulates over the next few decades. The biggest bank failure in American history took place when California entrepreneur Charles Keating plundered the Lincoln Savings and Loan Association. Some financial experts have attributed bank fraud to owners pushed to the brink of insolvency by adverse market conditions. These owners then gamble by making risky investments that would theoretically produce a high rate of return. This view neglects to take into account the evidence that the worst thrift failures, such as the Lincoln case, can be traced to investments that were unsafe, illegal, and involved substantial fraud.

Insurance insolvencies have also increased dramatically since the early 1980s. While the public usually describes insurance fraud as beneficiary fraud perpetrated by customers who file false claims, this is not the type of fraud that causes the most damage to the public. Premium diversion is a type of fiduciary fraud whereby funds intended to cover claims are diverted for other purposes. The fraudsters, typically owners of small businesses, simply vanish after collecting premiums from customers. More sophisticated schemes rely on creating a network of service and affiliate companies that bill larger companies for ambiguous items such as "operating costs."

Some analysts point out the insurance industry is dangerously under-regulated. Insurers must demonstrate that they have sufficient assets to meet capitalization requirements to pay potential claims. But many can and do cheat by inventing phony assets, renting assets, or temporarily acquiring assets to place on the books for only a day to meet reporting standards. One Texas company claimed that it

owned \$20 million in real estate but the property had been condemned by San Antonio authorities and did not possess a market value anywhere near the claimed amount.

States monitor insurers operating within their jurisdiction and the states require that many insurers contribute to a guaranty fund that is supposed to pay claims filed against a failed company. In practice, it has been reported that many claimants in such circumstances receive no benefits. Moreover, increases in guaranty fund assessments resulting from claims are passed along to the consumer in the form of higher premiums.

Fiduciary fraud committed by investment and financial services commonly utilizes a Ponzi or pyramid scheme. Investors are promised spectacular returns but their money is used instead to finance illegal securities speculation and exorbitant personal spending. The funds delivered by later investors are diverted to pay interest to early investors thereby delaying discovery of fraudulent behavior. The firms conceal losses by sending out false account statements, audit confirmations, and other similar documents.

The largest pension scam in American history involved a Ponzi scheme run by First Pension Corporation of Irvine, California. The managers of the firm began to behave fraudulently only one year after the company was founded in 1982. Company founder William Cooper, company President Valerie Jensen, and Chief Financial Officer Robert Lindley pleaded guilty in 1994 to cheating 8,000 First Pension clients out of \$66.7 million in direct investments and \$54.8 million in lost interest. Funds were never invested but were instead utilized to pay dividends and interest on older investments until the scheme collapsed and First Pension declared bankruptcy.

Pension funds are loosely regulated in the United States and this lack of governmental supervision has led to a plethora of criminal activity. The 2002 case of Concord, New Hampshire-based International Paper Box Machine Company is typical. The owners of the firm allegedly took money from employee paychecks intended for deposit into their 401(k) accounts but never forwarded that money to Fidelity Investments, managers of the accounts. In the lawsuit, the U.S. Department of Labor also claimed that the firm's owners failed to make corporate contributions to the accounts. Failing to forward employee contributions to 401(k) fund

accounts is a direct violation of the Employment Retirement Income Security Act (ERISA).

Fiduciary fraud is a growing criminal area because of combination of human greed and the failure of governments to impose adequate controls. Federal oversights are woefully deficient and regulators often appear inept, as fraudsters have repeatedly explained after their convictions.

#### SEE ALSO

savings and loan fraud; bank fraud; Keating Five; pension fraud; accounting fraud.

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## Film Recovery Systems

ON JUNE 14, 1985, in what legal experts say is the first case of its kind, Judge Ronald Banks convicted Steven O'Neil, Charles Kirschbaum, and Daniel Rodriguez, agents of Film Recovery Systems, Inc., of murder in the death of Stefan Golab, an employee, from cyanide poisoning. Banks, who heard the case without a jury, said the evidence during the eight-week trial clearly showed Golab died from inhaling cyanide under "totally unsafe" workplace conditions.

Golab's death, according to the judge was no accident, but murder. Corporate defendants, Film Recovery Systems and its sister corporation Metallic Marketing Systems, were convicted of involuntary manslaughter in the death.

The now defunct Film Recovery was a company engaged in the business of extracting silver from used X-ray and photographic film for resale. The recovery process involved "chipping" the film and soaking the granulated pieces in large, open vats containing a solution of water and sodium cyanide. The cyanide solution caused silver contained in the film to be released. Cyanide is a very poisonous chemical. Exposure to high levels of cyanide harms

the brain and heart, and may induce coma and cause death, as it did to Golab.

On the morning of February 10, 1983, while at work, Golab became dizzy and fainted. He eventually lost consciousness and was taken outside of the plant. The paramedics were called but were unable to revive him. Golab was pronounced dead upon arrival at the hospital. The medical examiner determined that he died from acute cyanide poisoning through the inhalation of cyanide fumes in the plant air.

Prior to Golab's death, numerous workers had complained of headaches, nausea, and vomiting—which are major symptoms of cyanide poisoning. In response to the complaints, management told the employees to go out and get some fresh air and that they could find another job if they wished. The indictment stated that the individual defendants failed to disclose to Golab that he was working with substances containing cyanide. The indictment also stated that the defendants did not provide adequate equipment to protect him from attendant dangers involved with working with the highly dangerous chemical.

O'Neil, Kirschbaum, and Rodriguez, were convicted of murder and sentenced to 25 years in prison. The application of criminal homicide laws to an occupational death was reportedly the first of its kind in the United States. However, the landmark murder convictions were overturned on appeal. The decision was reversed and remanded by an Illinois appeals court because the murder convictions were legally inconsistent with the manslaughter convictions of two other corporate defendants in the case. The ruling set the stage for a new trial for the men, the first corporate officials prosecuted for a work-related employee death.

On September 7, 1993, just prior to their retrial, the three former employees entered guilty pleas of involuntary manslaughter for the 1983 cyanide poisoning death of Golab. After entering the pleas, O'Neil was sentenced to three years in prison, Kirschbaum to two years in prison, and Rodriguez to 30 months' probation, four months of home confinement and 500 hours of community service.

The decade-long prosecution of these three corporate officers set the precedent that employers have obligations in the creation of a safe work environment. This case showed that employers can and will be held criminally responsible for workplace

fatalities if they or the company are negligent or reckless with safety measures.

#### SEE ALSO

workplace deaths; Occupational Safety and Health Administration; corporate liability.

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## Financial Accounting Standards Board

THE FINANCIAL Accounting Standards Board, which is often simply referred to as the FASB, is responsible for developing improved standards related to financial accounting and reporting. FASB is believed to be an important part of the accounting process because of the very nature of the economy and the stock market; this belief stems from the fact that many investors rely upon the financial statements issued from a company when determining which stocks to purchase, and an opinion from the FASB carries the weight of law.

Since 1973, the FASB has maintained the absolute authority to regulate standards for the accounting industry. While the Securities and Exchange Commission (SEC) has been granted statutory authority to make decisions concerning accounting standards, both the SEC and the American Institute of Certified Public Accountants (AICPA) have recognized FASB statements as authoritative in regards to accounting practices and policies.

While some consider the FASB to be a committee for establishing policies and procedures, the FASB is in actuality an independent structure consisting of a multi-divisional hierarchy. The first division is the Financial Accounting Standards Board,

which is the most recognized division and provides opinions on accounting standards. The Financial Accounting Standards Advisory Council (FASAC) is a lesser known division comprised of 30 members who consult with the FASB on technical issues, and the Financial Accounting Foundation (FAF) is the final division and is responsible for selecting the FASB members and ensuring that there are funds for the board to operate.

When the FASB is considering either a change or an addition to accounting standards the proceedings are open to the public and constituent views are openly accepted. In reaching a decision as to whether to consider an issue the FASB may consult with numerous other standard setting bodies such as the Accounting Standards Executive Committee (AcSEC) or the Auditing Standards Board of the AICPA. Once the FASB has completed consultation with these entities, several additional factors are then considered.

The pervasiveness of the issue is one of the first considerations and involves the FASB determining the extent to which the issue is currently impacting users. For example, the FASB may examine whether there are stark differences in how an issue is being handled and determine that the issue is of such importance that all users should be applying the accounting principle in a similar manner.

Additionally, the FASB will consider the impact a change may have on international accounting principles, and will occasionally consider whether there is support for a principle from one of the other national standard organizations. In reaching an agreement on proposed changes in standards, the FASB follows established principles. These principles are: to be objective in its decision-making, to weigh carefully the views of its constituents, to promulgate standards only when the expected benefits exceed the perceived costs, to bring about changes in ways that minimize disruption to the continuity of reporting practice and to review the effects of past decisions and interpret, amend or replace standards in a timely fashion.

#### SEE ALSO

accounting fraud; securities fraud; Securities and Exchange Commission; reform and regulation.

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## Financial Crime Kingpin Statute

IN RESPONSE to the late 1980s savings and loan scandal, where the largely unregulated savings and loan industry nearly collapsed after approving billions in insider loans for dubious projects, President George H.W. Bush signed the Crime Control Act of 1990. Title XXV of the Crime Control Act, the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990 (the Bank Fraud Act), criminalizes the concealment of assets from a bank conservator, obstruction of a bank examination, and administration of a continuing financial-crimes enterprise.

The last of these crimes creates a "Financial Crime Kingpin" statute. If convicted under the statute, individuals involved in a "continuing financial crime enterprise" who gross more than \$5 million over 2 years may be subject to imprisonment from 10 years to life, and fines up to \$1 million. Organizations found guilty under the statute may be fined up to \$20 million. The law also contains a "mini-kingpin" statute for a defendant who grosses more than \$1 million from a crime affecting a financial institution.

If convicted under the mini-kingpin statute, an individual may be subject to imprisonment for no less than 51–63 months. Any individuals convicted of criminal offenses involving dishonesty or breach of trust under the Financial Crime Kingpin Statute is barred from participating in the business affairs of a depository institution or savings and loan without approval of the Federal Deposit Insurance Corporation.

### FREEZING ASSETS

The act makes it easier for the FDIC and other federal law enforcement agencies to obtain a court order to freeze the assets of an officer or employee prior to a judgment by the courts. These provisions are strikingly similar to legislation passed to prevent drug kingpins and organized crime figures

from removing their illegally obtained assets from the reach of governmental authorities. The act also enhances the ability of a sentencing court to order a convicted defendant to make restitution to a victim directly harmed by the defendant's conduct. Finally, if an individual is found guilty under the law, the legislation bars a financial institution from compensating employees for expenses incurred in defense of actions brought by a regulatory agency.

Passage of the law bolstered federal supervision over the beleaguered savings and loan industry. To assure adequate monitoring of the new statute, Congress also approved additional funding for the Federal Bureau of Investigation, the offices of the U.S. Attorneys, the Criminal, Civil and Tax Divisions of the Department of Justice, the Internal Revenue Service, and the federal court system under the Bank Fraud Act. In addition to ushering in a new era of supervision of oversight for a number of banking and non-banking institutions, the new law set the framework for cooperative efforts among the various agencies working on criminal matters involving corporate, investment, and other financial institutions.

A decade later, the cooperative framework established by law enforcement agencies under the Financial Crime Kingpin statute would assist in investigations of securities markets, and accounting scandals related to the collapse of several major U.S. firms, such as Enron Corporation and WorldCom, which were linked to a series of illicit financial maneuvers that promoted public and Congressional calls for better oversight of financial institutions not covered under the Bank Fraud Act of 1990.

### SEE ALSO

Justice, Department of; bank fraud; organized crime; Enron Corporation; WorldCom.

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## Firestone tires

IN THE LATE 1990s, a series of fatal repetitive accidents occurred among drivers of Ford vehicles using certain Firestone tires (manufactured by Bridgestone/Firestone, Inc., the result of a 1990 merger) that experienced tread separation. This led to major recalls of tires by Firestone, free tire replacements by Ford Motor Company, an extensive investigation by the Department of Transportation (DOT), hearings before the U.S. Congress, and hundreds of lawsuits.

As reports of accidents involving the Firestone ATX, ATX II, and Wilderness tires began to mount in mid-2000, the National Highway Traffic Safety Administration (NHTSA), a division of DOT, opened its investigation. Under the provisions established by the National Traffic and Motor Vehicle Safety Act of 1966, in August, Firestone was forced to recall all of its ATX and ATX II tires in the P235/75R15 ATX series at a cost of approximately \$3 billion. Over an 18-month period, Firestone recalled tires in all 50 states. Problems with Firestone tires on Ford Explorers were also experienced in 12 foreign countries.

On May 22, 2001, Ford offered free replacement of approximately 13 million Firestone Wilderness tires on Ford Explorers, Mercury Mountaineers, and Mazda Navajo sport-utility vehicles (SUVs) and Ford Ranger trucks. A week after Ford's announcement, arguing that the cause of the accidents stemmed from a faulty design of Ford Explorers rather than with the design of the Firestone tires, Firestone filled an official request asking that the National Highway Traffic Safety Administration (NHTSA) begin an investigation into why so many Explorers crashed, sometimes rolling over, after tread separation occurred in the Firestone ATX and Wilderness AT tires. Firestone supplemented their request with data compiled by their own vehicle dynamics consultant. After examining Firestone's data, the Office of Defects Investigation (ODI) concluded that there was insufficient evidence to warrant an investigation into the Ford Explorer.

In response to public concern over automobile safety, the Transportation Recall Enhancement, Accountability and Documentation Act, popularly known as the TREAD Act, which was intended to ensure automobile safety and which was specifically aimed at accountability of tire manufacturers, was

introduced in the House of Representatives on September 13, 2000. Acting with uncustomary promptness, both houses of Congress passed the bill and handed it to the president by November 1. The TREAD Act became P.L. 16-414 on November 1, 2000, giving NHTSA the authority to regulate tire performance standards, tire pressure warnings, early-warning reporting regulations, roll-over testing, and child restraint improvements. A harsher bill that did not pass would have imposed criminal penalties on automobile executives who did nothing about known defects in automobiles and automotive equipment.

On October 4, 2001, NHTSA announced its investigation into Firestone Tires, concluding that the P235/75R15 and P255/70R18 tires manufactured at the Decatur, Illinois, Firestone plant and sold by Ford Motor company before May 1998 were responsible for a number of reported crashes, injuries, and deaths due to tread separations that caused drivers to lose control of their vehicles, often resulting in roll-overs. ODI extended its investigation to include Firestone tires manufactured in Wilson, North Carolina, and Oklahoma City, Oklahoma, in the United States and in Joliet, Quebec, in Canada.

On June 19, 2001, Michael P. Jackson, the Deputy Secretary of Transportation, reported to a joint session of Congressional committees that the NHTSA investigation revealed 285 crashes and 123 fatalities had been reported among the users of the 14.4 million tires recalled by Firestone. Thirty-seven crashes and 10 fatalities were reported among users of the 13 million tires included in Ford's replacement program, and another 15 crashes and five fatalities were reported in response to NHTSA's consumer advisory of September 1, 2001. An estimated eight crashes and 12 fatalities were reported among users of 23 million other Firestone tires not included in the other reports.

In addition to government investigations, hundreds of class action lawsuits were filed against both Firestone and Ford Motors, beginning as early as 1991. The majority of them were settled out of court, and the lack of publicity allowed Firestone and Ford to keep the problems from NHTSA as long as possible.

The 1990s tire fiasco was not the first time Firestone had tread-separation and recall problems. Back when the company was known as Firestone Tire & Rubber Co., on October 20, 1978, Firestone



recalled 10 million of its steel-belted radial 500 tires due to reports of treads ripping off, causing the tires to explode at high speeds. The resulting legal actions and damage to the company's nearly 100-year-old reputation led to the merger with Bridgestone in 1990.

#### SEE ALSO

automobiles; consumer deaths; National Highway Traffic Safety Administration.

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## Fisher-Price

THE U.S. CONSUMER Product Safety Commission (CPSC) reported that between 1994 and October 1998, Fisher-Price distributed nationwide, and before 1994, Kransco manufactured and sold nationwide, a total of approximately 10 million battery-powered 6- and 12-volt Power Wheels ride-on children's trucks and cars in almost 100 different models intended for children ages two to seven. Toy and mass-merchandise stores sold the vehicles for \$70 to \$300.

Between 1995 and July 1998, the Power Wheels vehicles were reported to be involved in 116 fires as well as 1800 incidents of the vehicles' electrical components overheating, short-circuiting, melting, or failing. These incidents resulted in at least nine minor burn injuries to children, and up to \$300,000 in property damage to 22 houses and garages. Additionally, Fisher-Price was aware of at least 71 incidents involving the products' failure to stop, resulting in six minor accidents when the vehicle hit a car, pole, window, or fence. Fisher-Price failed to report these problems until March 1997 and, then,

only in response to a February 1997 request from the Commission for a Full Report. According to CPSC Chairman Ann Brown, Fisher-Price knew about these problems for years without reporting to CPSC as they were required by law to do, nor did they voluntarily recall and repair Power Wheel vehicles.

The CPSC settled with Fisher-Price on charges of the company's failure to report serious safety defects of Power Wheels toy vehicles. In agreeing to the settlement and civil penalty of \$1,100,000—the largest fine against a toy firm in CPSC's history, Fisher-Price denied that it knowingly violated the Consumer Product Safety Act. Nonetheless, Fisher-Price recalled up to 10 million Power Wheel vehicles on October 22, 1998 including vehicles sold from 1984 to October 1998.

#### SEE ALSO

Consumer Product Safety Commission Act; defective products; unsafe products.

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## Fisse, Brent (1942–)

AUSTRALIAN ATTORNEY and author Brent Fisse is a specialist in trade practices law, intellectual property, e-commerce, and online services and liability control systems for corporations. He developed the theory of "organizational blameworthiness" for corporate crime and has argued that the common practice of imposing monetary penalties as sanctions against corporations does little to deter future bad behavior.

Fisse held a position as a professor of law at the University of Sydney from 1985 to 1996. Between 1993 and 1994, he acted as a part-time commissioner of the Australian Law Reform Commission specializing in trade practices compliance reference. He also served as a part-time commissioner of the New South Wales (Australia) Law Reform Commission from 1987 to 1999. Fisse joined the prominent Sydney law firm of Gilbert + Tobin as a partner on

February 1, 1995 after acting as a consultant to the company for several years.

Additionally, he is the author and editor of numerous books and journal articles on a range of subjects. His publications, including *Howard's Criminal Law* (1990) and *Corporations, Crime, and Accountability* (with John Braithwaite, 1993), address Australian communications law, accountability issues in corporate regulation, and securities regulation in Australasia.

Fisse is perhaps best known for the idea of "organizational blameworthiness" to overcome the approach adopted by courts following the Tesco Supermarkets case. In his view, the Tesco case unduly limited the scope of corporate criminal responsibility by focusing on the conduct of high-level managers.

This so-called directing mind and will approach made it difficult to establish liability against large corporations. Organizational blameworthiness attributes acts and omissions of employees, agents or officers of a corporation to the corporation itself, as long as the relevant person was acting within the actual or apparent scope of their employment or authority.

Fisse has also addressed the issue of penalties for corporate crime. Australian securities regulation is based upon pyramidal enforcement partly because of the influence of Fisse. The features of this system acknowledge the dynamics of negotiation and interaction, the diverse motivations of the regulators, and the need for an explicit pyramid of sanctions and remedies. While fines or monetary penalties are now used extensively as a sanction against corporations, Fisse has suggested that other sanctions would have more of an impact. Stock dilution (equity fines), probation, publicity orders, and community service also merit consideration as additional sentencing options, especially in regard to small companies. By increasing the variety of deterrents, these sanctions offer ways of angling around the major limitations of monetary sanctions.

#### SEE ALSO

Australia; corporate liability; differential association; reform and regulation; Braithwaite, John.

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## Flaming Ferraris

THREE FORMER Credit Suisse First Boston (CSFB) employees, known as the Flaming Ferraris for a cocktail they used to drink, were barred from securities trading, after an inquiry into an attempt to manipulate the Swedish OMX index in 1998. The men were part of a team which boasted of being the world's most successful share traders, making more than £100 million (\$170 million) for their employers, the CSFB investment bank.

The team included David Crisanti, a Princeton graduate in economics; Adrian Ezra, a Harvard-educated squash champion; and ex-Etonian James Archer, who studied chemistry at Oxford. The latter was reported to earn £250,000 (\$426,000) a year. Team bonuses were counted in millions. They enjoyed the best food and drink. It was at a fashionable London venue, the Nam Long Vietnamese restaurant, that they got their nicknames because of their penchant for £14-a-glass (\$24) Flaming Ferrari cocktails.

The trio's downfall came in 1999, when they were suspected of dubious dealings in shares of Swedish papermaker Stora. They were accused of forcing movements in the Stockholm shares index which triggered windfall profits of around £400,000 (\$682,000) on bets and futures deals they had placed. Archer said his finger had slipped on his computer keyboard and he had sold a million shares when the meant to sell 100,000. The team that specialized in equity arbitrage—the exploitation of differences between different stock-market indices—hit the headlines in December 1998 when they were touted as having made money on all but 12 days in 1998, an astonishing achievement given the economic turmoil of that year.

The Swedish stock exchange fined CSFB two million Swedish kronor (\$242,000) for an attempt to manipulate the Swedish stock-market index in the final days of 1998. Swedish brokerage firm Nordiska Fondkommission was fined 1 million kronor for its role.

Archer, Ezra and Crisanti each were employed by Credit Suisse First Boston (Europe) Ltd. Crisanti was global head of Index Arbitrage. Ezra was a vice president in Equity Index Arbitrage responsible for European Index Arbitrage, including the Swedish book. He reported to Crisanti. Archer was a junior trader on the index arbitrage desk, responsible for trading the Swedish book. He reported to, and sat next to, Ezra. The three were close friends. They were found guilty of “a blatant attempt to manipulate the OMX Index on the SSE on the morning of December 29, 1998, and of persistent attempts to disguise the circumstances from SSE Market Surveillance and from CSFB’s compliance department.”

The three were dismissed by CSFB. Nordiska Fondkommission also fired the broker involved. The exchange’s disciplinary committee ruled that the trades took place without the consent or information of the two firms’ management. Nevertheless, the companies are considered responsible for the actions of their employees under Swedish law.

#### SEE ALSO

arbitrage; securities fraud; insider trading.

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## Food and Drug Administration

THE FOOD AND Drug Administration (FDA) is a government agency housed within the Department of Health, Education and Welfare. It is charged with the enormous task of monitoring the safety, quality, and efficacy of the food, drugs, medical devices and biological products, and cosmetics that enter the consumer market.

The agency’s work is further complicated by the need to keep apace of scientific and technological advances while balancing competing pressures emanating from an ever shifting coalition of politicians, business interests, and consumers. While history suggests that consumers suffer disproportionately if

the agency fails, the high degree of public confidence in the safety of our food and drugs attests to the agency’s success. Unfortunately, the FDA’s current reputation is captive to past tragedies central to the expansion of powers needed to strengthen its regulatory functions.

#### HISTORY

Over the course of the 1800s, states became increasingly unable to coordinate efforts to combat the proliferation of often questionable and dangerous food and drug products. Yet, the framework for the modern FDA was not erected until 1906 when Congress passed the Food and Drugs Act. In response to public outrage unleashed by Upton Sinclair’s *The Jungle*, which exposed widespread unsafe and unsanitary conditions in the meatpacking industry, a new agency was created.

Manufacturers were required to list dangerous ingredients and the agency had the power to seize illegal foods and drugs. While the regulatory functions of what is now known as the FDA have since expanded, the cost of expansion has been a series of high profile tragedies.

The Federal Food, Drug and Cosmetics Act of 1938 was passed in response to the sulfanilamide tragedy. Sulfanilamide was used as an antibiotic in its pill form. In an effort to market the drug in liquid form, in 1937 a drug company used a solvent that produced a lethal mixture linked to 107 deaths. This legislative response made testing and labeling mandatory, and the act has been revised nearly annually in response to new challenges.

Animal testing and clinical trials did not become standard procedure until the 1962 Kefauver-Harris Amendments. These amendments were passed when a U.S.-based drug company sought to market the tranquilizer thalidomide, linked to extreme deformities in European infants. In this case, the FDA successfully safeguarded American consumer interests against the profit-driven motives of powerful pharmaceutical companies.

#### DRUGS AND IMPLANTS

The path of a new drug to market is long and arduous. Any new drug must first be tested on lab animals for more than three years before the manufacturer is permitted to test on human subjects. The drug then undergoes three phases of clin-



*The safety of the American food supply is under the regulation of the Food and Drug Administration.*

ical testing, each with increasing numbers of human subjects receiving the drug in a controlled setting. After a lengthy six-year process, a manufacturer may submit a new drug application with extensive documentation of findings. Approval takes an additional thirty months on average. Once approved, manufacturers enjoy a period of patent protection without competition.

Pharmaceutical companies engage in an ongoing fight on multiple fronts with the FDA to subvert the above process. Industry interests have undermined FDA oversight functions by bribing its officials to relax procedures, falsifying test results, lobbying politicians, and mobilizing disease-specific advocacy groups. When industry succeeds, consumers face considerable danger.

History is riddled with accounts of the disastrous effects of drugs released by companies that knowingly concealed and falsified associated risks. For example, the synthetic estrogen Diethylstilbestrol (DES) was initially distributed in the early 1940s to prevent miscarriage. It was not removed from the market until 1971, despite evidence of dangers that emerged even before manufacturing companies applied to the FDA. DES is now known to cause cancer, sterility, and deformity among the children and grandchildren born to women who took the drug during their pregnancies.

Women were similarly victimized by producers of silicone gel breast implants. In this case, women suffered because the FDA was not given regulatory control over medical devices until 1976, long after silicone breast implants had been on the market. Once FDA powers were expanded, interests organized to resist regulation. Herbert Burkholz details the history of silicone and breast augmentation, suggesting that clear risks emerged shortly after its introduction following World War II. University of Texas studies conducted in the 1970s showed that implants evoked an auto-immune response, causing symptoms such as the hardening of breast tissue, joint pain, and rashes.

The FDA threatened to ban implants in the absence of data demonstrating their safety. The battle that ensued, pitting the FDA and women's advocacy groups against pharmaceutical companies and physicians, continued throughout the next two decades. Philip J. Hiltz contends that the FDA took the politically safe middle road by allowing saline-filled implants while limiting the usage of silicone implants to controlled settings for further testing.

According to Burkholz, pharmaceutical companies were positioned to achieve further victories in the 1980s. Regulation shifted from the public to the private sector as the spread of HIV gave rise to disease-specific interest groups that lobbied Congress for rapid release of potentially life-saving drugs. Their efforts were mirrored by industry and supported by a conservative administration that supported less regulation as integral to competition and innovation. At the same time, drug costs escalated as companies sunk more money into marketing.

Burkholz contends that this atmosphere produced the 1984 Drug Price Competition and Patent Extension Act that curtailed FDA regulatory functions. Pharmaceutical companies could now pro-

duce generic drugs that replicated the existing, more expensive brand-name drugs.

Replication allowed companies to circumvent many phases of the lengthy test process. As an unintended consequence, new drug companies producing only generic drugs entered the market alongside established entities. The FDA faced the new challenge of holding inexperienced companies accountable for mishaps when rising numbers of complaints undermined its ability to file charges.

## SUPPLEMENTS

Events of the 1980s arguably set the tone for government decisions in the 1990s. In 1994, Congress passed the Dietary Supplement Health and Education Act, deregulating the supplement industry. Ironically, writer Michael Specter argues that deregulation extended from public suspicion of pharmaceutical companies' motives matched by a desire for more control over individual health. The appeal of supplements is that they are composed of naturally occurring vitamins, minerals, and medicinal herbs. Natural, however, does not mean safe.

Dietary and weight-loss supplements are not government approved, manufacturers use slippery language to make claims unsubstantiated by tests and data, and they are not obligated to provide warnings about the potential risks of their products. Yet, many supplements aggravate existing medical conditions and are toxic when taken in combination with other supplements or pharmaceutical products.

The FDA once again found itself in uncharted waters. After the much-publicized death of Baltimore Orioles's pitcher Steve Bechler in 2003, the FDA banned the dietary supplement ephedra. Bechler suffered a fatal heat stroke after taking ephedra, which elevates blood pressure, heart rate, and brain activity. Ephedra's active ingredient, the stimulant ephedrine, is common in supplements for weight-loss and improved physical performance. The ban's impact is limited since it does not extend to practitioners of traditional Chinese medicine who use *ma huang*, ephedra's herbal incarnation. Moreover, the ephedra ban covers only one supplement in a booming industry.

Current challenges to FDA regulatory functions extend from a need to accomplish more with fewer employees and a fraction of the budget allocated to other bureaucratic entities. Though often aided by

the efforts of consumer watchdog organizations and advocacy groups that raise money to conduct their own testing, the FDA is at a monetary and scientific disadvantage in its quest to stay ahead of pharmaceutical companies and agribusiness. Perhaps the FDA performs quite well within a complex environment that makes mishaps unavoidable.

## SEE ALSO

Pure Food, Drug and Cosmetic Act; pharmaceutical industry; breast implants; Sinclair, Upton.

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## Ford Pinto

IN 1971, FORD Motor Company introduced the Pinto as its entry into the subcompact market. Fighting strong competition for the lucrative small-car market, Ford rushed the Pinto into production in much less than the usual time.

Ford engineers discovered in pre-production crash tests that rear-end collisions would rupture the Pinto's fuel system. Because assembly-line machinery was already tooled when engineers found this defect, Ford officials decided to manufacture the car anyway, even though

Ford owned the patent on a much safer gas tank. For more than eight years, Ford successfully lobbied against a key government safety standard that would have forced the company to change the Pinto's gas tank.

Pinto crashes caused between 500 and 900 burn deaths to people who would not have been seriously injured if the car had not burst into flames. Ford knew the Pinto was a firetrap, yet still paid out

millions to settle damage suits out of court, and was prepared to spend millions more lobbying against safety standards. In late models, the bumper was designed to withstand a collision of only about 5 miles per hour (mph). Earlier bumpers offered even less protection to the gas tank.

Internal Ford documents demonstrate that Ford crash-tested the Pinto at a top-secret site more than 40 times, and that every test made at over 25 mph, without special structural alteration of the car, resulted in a ruptured fuel tank. Yet, Ford executives denied under oath having crash-tested the Pinto.

Only three cars passed the test with unbroken fuel tanks. In one of them, an inexpensive lightweight plastic bladder was placed between the front of the gas tank and the differential housing, so four bolts would not pierce the tank. In another successful test, a piece of steel was placed between the tank and the bumper. In the third test car, the gas tank was lined with a rubber bladder. But none of these protective alterations was used in the mass-produced Pinto. When it was discovered the gas tank was unsafe, no one told Ford chief executive Lee Iacocca, who insisted that safety concerns take a back seat putting the car into production, and that the car not weigh over 2,000 pounds or cost more than \$2,000. Iacocca feared that adding even \$25 more to the car's cost would price the Pinto out of the small-car market.

In June 1978, Ford was forced to recall 1.5 million Ford Pintos and 30,000 Mercury Bobcat sedan and hatchback models. The action was the result of investigations by the National Highway Traffic Safety Administration's (NHTSA) Office of Defect Investigations. In April 1974, the Center for Auto Safety petitioned the National Highway Traffic Safety Administration to recall Ford Pintos. The Center's petition was based upon reports from attorneys of three deaths and four serious injuries in Pinto accidents. This petition languished in the NHTSA offices until 1977.

In 1977, Mark Dowie of *Mother Jones* magazine, using documents in the Center files, published an article reporting the dangers of the fuel tank design, and cited internal Ford Motor Company memos proving that Ford knew about the fuel tank problem before the vehicle was produced, but that a cost/benefit memo concluded that it would be "cheaper" for Ford to pay liability for burn deaths and injuries rather than modify the fuel tank to pre-

vent the explosions. Following the publication of Dowie's article, an Orange County, California, jury, awarded Richard Grimshaw \$125 million in punitive damages for injuries he suffered as a passenger in a 1971 Pinto struck by another car at 28 mph. The award was reduced to \$3.5 million. The jury wanted punitive damages to be more than Ford Motor Company had made in profit on the Pinto (\$124 million).

An Elkhart, Indiana grand jury returned indictments against Ford for three cases of negligence from the deaths of three young women burned in Pintos. But on March 13, 1980, a jury found Ford innocent of a charge of failing to warn about or offer to repair fuel system defects in the Pinto before the day the three women were fatally burned. The verdict was not an unfavorable precedent with regard to criminal prosecution of corporations for defective products that can kill, and the possibility of successful corporate criminal liability suits in the future remains open.

#### SEE ALSO

consumer deaths; negligence; automobiles; General Motors; unsafe products; defective products.

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## Ford, Gerald R. (1913–)

GERALD FORD HOLDS a unique position among American presidents because he is the only president never elected by the electoral process. When Spiro Agnew (1918– ) resigned as Vice President of the United States on October 19, 1973, after having been accused of taking bribes as governor of Maryland and after being indicted for income tax evasion, President Richard Nixon invoked a provision of the 25th Amendment that allowed the president to nominate a new vice president when the office was vacated.

The effectiveness of the Ford administration was threatened from the beginning by the aftermath

of the Nixon Watergate scandal and the general political unrest of the times. The Ford Department of Justice (DOJ) was heavily involved in stemming the white-collar crime and government corruption that had been rampant during the Nixon years. Federal investigators were also burdened by the effects of the Vietnam War, chasing down and prosecuting those who evaded the draft. While Attorney General Edward H. Levi directed efforts at stemming and prosecuting business and government corruption, the president was kept busy fighting with Congress over the War Powers Act, which affected the administration's ability to engage United States troops in combat abroad.

Ford's legacy in white-collar crime may be derived from his handling of Nixon's role in the Watergate scandal. Seeming to forget that "truth [was the] glue that holds governments together," in September 1974, Ford suddenly and secretly pardoned Nixon who had been named as an un-indicted co-conspirator in the Watergate trials. Reaction to the pardon was swift, and Ford's legitimacy as a reform president was tarnished as a sense of betrayal enveloped the nation. Thus, Ford's legacy is one of pardoning perhaps the highest-ranking, most elite white-collar (alleged) criminal in the history of the United States: Nixon.

Ford began the move toward government deregulation that would continue with Jimmy Carter and which would go into high gear with Ronald Reagan in the 1980s. Ford used the Council of Economic Affairs (CEA) to analyze the effects of deregulation and begin the process of putting such policies into effect. Ford also created the Economic Policy Board (EPB), which was given the responsibility for coordinating domestic and foreign policy for the Ford administration. Along with the move toward deregulation, Ford initiated a move toward enhanced federalism that would also reach its height under Reagan, with states being given more control and responsibility in various social and economic programs.

Ford's long experience in the House of Representatives helped him in the presidency, and he generally enjoyed a good working relationship with Congress. Yet, because Congress was in the process of restoring its presence as an equal power in the three-branch government, Ford was often unsuccessful at gaining Congressional approval of his proposals. He did have some major successes, including in 1974 when Congress passed the Em-

ployee Retirement Income Security Act that regulated private retirement benefits.

Ford also worked with Congress to raise the minimum wage and extended it to domestic and farm workers. Among the Democrats, he won some support from Democratic women for his strong support for the Equal Rights Amendment that would have prohibited discrimination on both national and state levels on the basis of sex. Ford's electoral defeat in 1976 was cemented by inflation, recession, high unemployment, and the aftermath of the Nixon pardon.

#### SEE ALSO

Carter, James E.; Nixon, Richard M.; Watergate.

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## Foreign Corrupt Practices Act

IN THE WAKE of Watergate and several corporate scandals in the 1970s, Congress and the Security and Exchange Commission (SEC) turned their attention to investigate corporate business practices. A SEC survey covering a large number of American corporations revealed that about 350 corporations were involved in bribing of foreign officials and were contributing to political campaigns of foreign politicians to the tune of \$750 million in order to receive lucrative government contracts.

Major oil companies (for example, Gulf Oil, Mobil Oil) and defense contractors (Lockheed, Northrop, Boeing, McDonnell Douglas) were involved in some of the well-known bribery cases. For example, the Lockheed Corporation admitted paying out more than \$22 million to officials and political organizations in several different countries including Indonesia, Iran, and the Philippines.

One of the most notorious cases in the 1960s involved the \$1 million paid to Prince Bernhard, the husband of Queen Juliana of Netherlands, for his

help in arranging the sale of fighter planes to the Royal Dutch Air Force.

Another major Lockheed bribery affair occurred in Japan in 1972 when, among other officials, Prime Minister Tanaka was paid off in a multi-million dollar deal to buy 230 Starfighter airplanes for the Japanese Air Force. This case became one of the major political scandals in postwar Japan and led to the arrest of Tanaka. Several other major international bribery cases were revealed during the early 1970s. The ensuing international scandals had adverse effects on U.S. relations with several foreign countries and made it harder for American companies to conduct business as usual in some of them.

The U.S. Congress responded to this situation by enacting the Foreign Corrupt Practices Act in 1977 making it a crime for American companies and their subsidiaries to bribe foreign government officials. The main aim of this act was to deter the bribery of foreign officials by including harsh penalties for violation. Violations were punishable by a prison term of up to five years and a maximum fine of \$250,000 for an individual and \$2 million for a corporation. The act had an accounting provision as well which required that corporate books and records be maintained in detail and reflect correctly the corporations' financial situation.

### MINOR BRIBERY

There was pressure from the business community to exclude from the act the relatively small payments paid to foreign clerical officials in order to expedite the issuance of various licenses needed to complete transactions with their governments. American companies doing business abroad claimed that these payments are not only customary, but also necessary in certain countries to facilitate the routine governmental contracting process. These arguments did influence Congress, and in 1988 it excluded this kind of minor payments from the act.

Also, there were two exceptions that critics consider as loopholes in the act. One allowed payment for promotional expenses such as travel and lodging for foreign officials who visit a company's plant to view a demonstration of the product. Second, payments were allowed that were considered lawful according to the laws and regulations of the country with which the business transactions were conducted.

American corporations claimed that the Foreign Corrupt Practices Act put them at a disadvantage with their competitors from other countries that did not have comparable legislation. However, in the current international marketplace where many major corporations are multinational, it is possible to continue paying off foreign officials by using subsidiaries located in countries that do not have laws prohibiting this kind of practice.

### SEE ALSO

bribery; illegal competition; corruption; Coleman, James W.; Arab nations; South America; Asia; globalization.

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## forensic auditing

**ALSO REFERRED TO** as forensic accounting, forensic auditing has been defined as an accounting analysis that is performed with a probability of later use in either a civil or criminal legal proceeding. In many criminal investigations, especially those involving criminal enterprises, the mantra "follow the money" is regularly heard; forensic auditing answers that demand.

Through adaptation of accepted accounting procedures, assets can be tracked to their origination and later disbursement. Similarly, forensic auditing can establish if spending patterns are indicative of criminal activity.

Forensic auditing can therefore be divided into two broad classifications: litigation support and investigative accounting. Forensic auditors perceive the information-gathering process as more than a review of ledger information but as research into the operation as a whole. Accounting, auditing, and investigative skills are utilized to obtain an under-



standing of an operation. Does the accounting of the operation explain the flow of monies in and out of the system; is there any indication that any transaction have been reported in such a way as to disguise its origin; is there any indication that criminal activity is taking place; and is any transaction designed to avoid federal reporting criteria?

## WHAT AN AUDITOR DOES

Specific antifraud duties a forensic auditor conducts include:

*Business/internal employee fraud:* the investigation of a business operation to ascertain if fraud exists, and if it does, to what extent and committed by whom. Additionally, a quantification of the loss is made, as well as a recommendation on methods of recovery. The process would also include the development and implementation of internal rules to prevent a reoccurrence.

*Business economic losses:* the involvement of the audit process to identify and quantify certain economic losses, that is, contract disputes, product liability, patent infringements, and construction breach of contract claims.

*Business interruption losses:* cases in which a forensic auditor is assigned to quantify the amount of calculated losses.

*Criminal investigation:* the involvement of the audit process in cases which will require information to be later presented at a criminal proceeding. The auditor can be retained by a law enforcement agency or by a party to the action.

*Matrimonial disputes:* forensic audits are utilized in disputes of this type to verify the assets of parties to a matrimonial dispute, quantifying the assets present as well as identifying any attempt to conceal assets.

*Professional negligence:* forensic auditors can quantify losses in cases involving alleged negligence of professionals other than accountants, and in cases involving accountants, they can both quantify losses as well as review adherence to generally accepted auditing or accounting principles.

*Shareholder claims:* cases in which forensic auditors are retained to examine claims by made shareholders of mismanagement, and possibly criminal fraud by company management. Recent cases of this type have involved Enron Corporation and WorldCom, with shareholders alleging losses due to fiscal mismanagement by upper management.

The usage of forensic auditing in investigating criminal enterprises is essential to prosecution efforts; the trail of money will provide investigators and prosecutors with evidence with which to charge individuals, possibly with Racketeer Influenced Corrupt Organization (RICO) charges. The majority of many criminal enterprises are cash operations, often in amounts that would require the filing of mandated federal banking documents. Criminal enterprises need to conceal the origin of their illegally obtained profits and seek to do so through money-laundering, transferring monies back and forth through various accounts. In other cases, some criminals decide to enjoy the fruits of their labors and begin to spend money in amounts beyond their earning capabilities.

One forensic auditing technique is the net worth audit. In this type of audit, the amount of verifiable spending a person has done over a period of time is compared to verifiable earnings over the same time period. Even with legitimate jobs as sources of income, an unexplained difference in spending versus earnings will be exposed. Gambino crime family member John Gotti, known for his extravagant spending style, including thousand-dollar designer suits, claimed that his employment as a plumbing supply salesman was his only source of income.

## UNDER THE VEIL

Forensic audits are often able to remove the various subterfuges employed to conceal the trail of money, including violations of federal banking laws. For example, in an attempt to bypass the required federal notification of any cash transaction over \$10,000; smurfing (making a series of lesser transaction) is often employed. Forensic auditors would be able to trace the smurfing activity and provide evidence of intent to the prosecutors. Forensic audits would also be able to identify collusive banking institutions that assist in the criminal concealment of laundering transactions.

One noted forensic audit was Operation Tradewinds, a federal investigation in the late 1960s which involved following large amounts of illegally obtained money from casinos in Las Vegas sent to the Bahamas and then back to the United States. The criminal organizations involved took advantage of banking laws in the Bahamas that would normally be advantageous in laundering the funds.

However, through the use of forensic audits, the veil of offshore banking was uncovered: 13 criminal investigations were opened and \$25 million in taxes and penalties was recovered.

Other investigations assisted by forensic auditing include corporate compliance investigations and due diligence investigations. In corporate compliance audits, adherence to state and federal financial regulations is reviewed. Due to a myriad of complex financial regulations, which often deviate slightly from state to state and within various federal and international programs, forensic auditors can review the business operation to ascertain that all pertinent guidelines are being followed. If violations are noted forensic auditors can then determine if the actions were accidental or intentional acts to conceal illegal activities. Secondary phases of compliance audits can involve environmental and labor rules, including adherence by subcontractors. If an affiliated manufacturing partner is in violation of Environmental Protection Agency (EPA) guidelines (for example, spillage of hazardous waste into the water table), the senior company can be held civilly liable. The forensic audit can determine if the actions are intentional and therefore criminal in nature.

Labor violations by subcontractors can both cause legal and public relations complications for corporations. Forensic auditors can review employment, payroll, and production records to determine if management is attempting to conceal labor issues from the senior corporation. In recent years Nike, Wal-Mart (Kathie Lee Fashions), K-Mart, Land's End and J.C. Penney have all faced allegations in the press of violations of labor laws by subcontractors.

Due diligence investigations often involve premerger activities of corporations; with the acquiring company determining the fiscal strength of the company to be purchased. The focus of the forensic audit in these cases is to determine if any questionable financial accounting procedures have been utilized in an attempt to strengthen the fiscal outlook of the company to be purchased. Also, the ownership of the company is reviewed to learn if any hidden owners exist, and, if so, their reason for concealing their identities.

Forensic auditors will review current contracts to develop their accuracy and value, to see if the contracts are "paper tigers" contracts written not to produce revenue, but only to create the appearance of future revenue. Additionally, secondary business

units are reviewed to ensure that their financial structure is sound.

Several professional forensic auditing organizations currently exist, including the American College of Forensic Examiners, the Association of Certified Fraud Examiners, and the Forensic Accountants Society of North America. These organizations strive to advance the professionalism of forensic auditing through establishing accepted standards and certification programs. The *Journal of Forensic Accounting* provides recent empirical and theoretical studies in the forensic auditing field.

#### SEE ALSO

bank fraud; accounting fraud; Financial Accounting Standards Board; Enron Corporation; WorldCom.

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## forgery

FORGERY IS GENERALLY understood to be the falsification of a person's signature, usually on a check, a deed, or some instrument of importance. The crime of forgery assumes an intent to defraud, with a non-genuine item being offered as genuine. Forgery is also referred to as *uttering* which is defined as: offering as genuine an instrument that may be the subject of forgery and is false with the intent to defraud. In some instances the act of counterfeiting is used synonymously with forgery.

Forgery is the integral component of many frauds and scams; it can be a criminal act unto itself but is often a part of criminal operation. Art forgery was originally believed to be a type of homage to the great masters, but once the forgeries were sold commercially for profit the threshold of criminal forgery was met. Forgeries range from the common, signatures on checks, to the rare, incarcerated

prisoners obtaining their releases with documents they produced in the prison print shop. Some examples of forgery include:

*AKC registration record forgery:* involves the forgery of American Kennel Club (AKC) records to identify the pedigree of individual dogs and their litters. Forgeries have been uncovered in which potential buyers of certain pedigree lines have later learned that their purchases were based on forged AKC registration documents. Similar attempts have also been noted in the thoroughbred, feline, and rare-bird industries.

*Antiquities fraud:* involves the forgery of items, excluding archeological, art works, and literary works claimed to be from various time periods. This fraud type includes works such as furniture, weapons and clothing, and antiques in general. As with the works of the grand masters of art, some forgeries are so convincing that legitimate dealers and collectors are often victims of the scam. Casual collectors are easily talked into buying these forgeries especially if a spectacular story is attached to the purchase, or in cases where the buyer believes that they are “scamming” the seller and getting a prized collectible for an incredible bargain. As is the sign of a perfectly executed scam in many instances the victim will never know that a fraud occurred.

*Archeological forgery:* the forgery of fossils and related items. One noted example is the 1999 discovery of the Archaeoraptor, offered as the missing link between dinosaurs and birds. Detailed inspection later revealed that the fossil was actually a composite created from five specimens from at least two different species. Other archeological forgeries include the Holly Oak pendant, a drawing of a mammoth on a seashell “discovered” in Delaware; the Calaveras Skull, the only evidence of Pliocene Man in North America; Piltdown Man, the jaw of the missing link proving the evolution of man from apes “discovered” in Sussex, England; and the Lenape Stone, an “unearthed” aboriginal carving which was offered as proof that mammoths roamed North America.

*Art forgery:* has been detailed in both print and films, highlighting some notable art forgers. In some situations, art forgers have later been recruited to detect forgeries, yet allegedly on more than one occasion, they have verified the authenticity of their own forged works. John Drew, a noted English art forger, would forge an artwork and then forge documents concerning the piece’s history which would

later be found by researchers seeking to authenticate the work.

Other noted art forgers include Elmyr de Hory who is said to have forged over \$60 million dollars of Renoirs, Modiglianis, and Matisses with many of his works still hanging undetected in museums and galleries; Guy Hain who flooded the art market with forged versions of Rodin’s bronze statues and generated over \$25 million in sales; Tom Keating who began his painting career as a house painter but went on to forge the works of Degas, Renoir, Goya, and Rembrandt, allegedly producing more than 2,000 forgeries; and Brigido Lara who forged over 3,500 pieces attributed to the Vera Cruz culture and is now employed as an expert to detect other forgeries from that period.

*Autographed sports memorabilia:* involves the forgery of noted sports figures either on items related to their sport (baseballs, footballs, boxing gloves, and helmets) or on non-sports related items (paper, pictures, autograph books). Autographs of famous sports figure, such as Mohammed Ali, Pél  , Barry Bonds, Sammy Sosa, Babe Ruth, Mickey Mantle, Joe DiMaggio, Michael Jordan, Joe Montana, and Venus Williams are highly sought and collectors are willing to pay premium amounts for them.

As many sports memorabilia are obtained “in the field,” later signatures are not always an exact match, and as sports figures age their handwriting changes. These differences make authenticity comparison difficult. Many memorabilia forgers will either produce photographs of them near the sports figure featured or forge certificates of authenticity to convince wary buyers.

*Check forgery:* involves the forgery of either the check itself or the signature. In some cases, the check itself is a forgery, using either legitimate or fraudulent account numbers. The forged instruments are then often used to purchase retail merchandise that is then converted to cash. The forged checks are often cleared by some check verification systems as the legitimate account numbers will not be declined for acceptance until the first forgeries are declined at the bank.

The fraudulent account numbers will have no negative history (insufficient funds or closed account), and since many verification services use a negative database to identify at-risk checks, these checks will not be declined. Often, the persons attempting to pass forged checks will have fraudulent identification in the name of the check account

holder. The second forgery type involves legitimate checks in which the signature or other information on the check is altered. In cases where a checkbook is stolen, the name of the account holder is written by the person now attempting to use the stolen check. If a check that has already been filled-out has been stolen, either the amount, payee, or payer can be forged, often removing any of the information through a check-washing process.

*Coupon forgery:* involves the forgery of legitimate coupons and the creation of fraudulent coupons to defraud retailers. Forged coupons are either presented by the forgers or are sold to second parties. To create the look and feel of legitimate coupons, efforts are made to print the forgeries on newspaper stock and then subject to short periods of harsh treatment to replicate a purse-worn quality. Some coupons are embossed with the universal product code (UPC) bar codes to pass register-scanning verification processes.

Forged coupons have been issued against a range of retailers, including sandwich shops, appliance stores, discount stores, franchise automotive repair shops, hotel chains, pharmacies, and service companies. Additionally, some coupons are manufactured in volume, not to be presented at individual retailers but sold to criminally complicit retailers who redeem them as part of their retail operation.

*Currency forgery:* often referred to as currency counterfeiting, this forgery concerns the replication of a country's currency. With the introduction of the euro in 2002 and its 96 variants of coins and bills, forgers took advantage of the public's untrained eye and ability to discern real euros from forged versions and produced multiple forgeries. U.S. currency is the currency most forged, due to its underlying economic strength and acceptance worldwide.

As such, it utilizes state-of-the-art anti-counterfeiting technology. Professional currency forgers now share the illegal market with amateurs who use color copiers and laser printers. Some forgeries simply involve the alteration of currency (a separate criminal offense), that is, covering the four corners of a \$1-bill with corners from a \$20-bill, or taping the halves of different denomination bills together (showing the higher denomination when passing the altered bill). The forgery of other government obligations, for example, bonds and postage stamps, would be included in this classification.

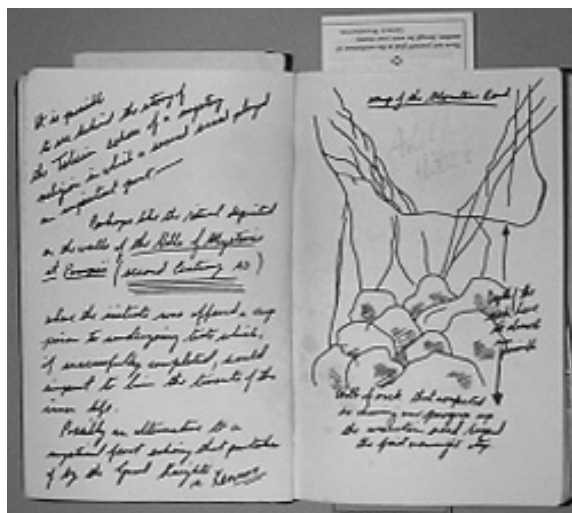
*Exam results forgery:* involves the falsification of various exams, including the SATs, professional licensure, stockbroker-certification courses, federal and state civil service examinations, chauffeur-driving tests, and high-school exit exams. Some of the score forgeries are perpetrated by teachers whose salaries are tied to passing rates, while in other cases, the forgeries are executed for monetary reasons. In some instances, the forgery effort is pervasive throughout an organization, while in others, only one person may be involved.

*Internet forgery:* involves the takeover of a legitimate website so that "spam" messages may be sent through the legitimate site. The act of forgery involves causing a false originating-sender to be identified on the electronic transmission. One case involved messages concerning pornographic websites and get-rich schemes that were disguised to appear that they were coming from an IBM website. Other internet forgeries involve a fraudulent sender-address being assigned to incoming emails for other than commercial reasons, that is, harassment or concealment of criminal activity.

*Government documentation:* involves the forgery of any of a myriad of government documentation including social security cards, birth certificates, death certificates, retailer permits (alcohol, cigarettes), immigration status documentation, import/export verifications, passports, identification cards, vehicle inspection tags, drivers' licenses, health department immunization records, tax stamps, and professional certification documents (taxi driver permits, mechanical operator's licenses, nursing licenses, etc.). The forged documents are sometimes the end result of the criminal activity and, in other instances, the forgery is only a part of a criminal operation.

*Insurance-fraud related forgeries:* involves the forgeries of any documentation utilized in the furtherance of an insurance fraud. These documents can include altered or totally fraudulent police reports of accidents and crimes, tax returns and W-2 filings to claim increased losses, medical reports and records to exaggerate the seriousness of the injuries suffered.

Forgeries of this type can also involve birth certificates as noted in the recent 9-11 World Trade Center incident, in which several persons filed insurance claims for nonexistent family members who were "killed" in the attack. In worker-compensation fraud cases, often timesheets or trip sheets are al-



Pages from "Hitler's Diary," one of the classic cases of literature fraud that sold for \$4 million.



The alleged burial box of James, brother of Jesus, turned out to be a prime religious artifact forgery.

tered to secure coverage that is applicable only if the injury occurred during working hours and in the completion of work assignments.

**Literary forgery:** involves the alleged authenticity of certain literary works to be genuine as to either authorship or content. Some noted examples include: Clifford Irving's "autobiography" of Howard Hughes in 1972 which was discredited by Hughes before its publication; Konrad Kujau's *Hitler's Diary* (a forgery that was purchased by West Germany's *Stern* magazine for \$4 million in 1983, and was later discovered to be printed on paper manufactured after 1950; and Leonard Lewin's *Report From Iron Mountain* released in 1976 which claimed to be a report of a government sponsored think-tank on the need for the United States to be at war as permanent peace in the world would destabilize the country. The government immediately denied the existence of any such government sponsored group or report; however the book became a *New York Times* bestseller and ultimately translated into 15 languages. In 1972, Lewin admitted that he created the entire report after reading an article on a Wall Street stock market dip caused by a peace scare.

**Medical records forgeries:** this fraud involves the alteration of medical records, surgical notes, nursing notes, medication records, intake notes (allergies), progress notes, doctor's notes, discharge summaries. The forgeries are often related to litigation

or possible litigation, concealing a medical or nursing act of malpractice either through omission or commission. Additionally, some prescription records are forged to facilitate the theft of narcotics by medical personnel, that is, charting that a narcotic was given to a patient but was actually taken by the caregiver. In other cases, narcotics are designated as damaged or "wasted" (entire amount was not given to patient and remaining amount was poured into medical waste container or sink) when in actuality, the caregiver retained the narcotic.

**Nongovernmental documentation:** involves the forgery of documentation emanating from the private sector rather than the public sector. These documents include: high school and college transcripts, corporate letters of credit, corporate letters of reference, bills of lading, event tickets, proof-of-insurance, and proof-of-purchase records.

**Nonsports related autographs:** involves the forgery of autographs of figures in history, literature, Hollywood, and science. Examples of commonly forged autographs include John F. Kennedy, Neil Armstrong, Ernest Hemingway, Samuel Clemens (Mark Twain), Albert Einstein, Thomas Edison, the Beatles, Elvis Presley, James Dean, Bruce Lee, Marilyn Monroe, Judy Garland, Elizabeth Taylor, and Barbra Streisand.

**Prescription forgery:** involves the forgery of legitimate prescription forms or the counterfeiting of prescriptions pads in an attempt to obtain con-

trolled substances from pharmacies. These forgeries can involve either the alteration of a properly obtained prescription from a healthcare provider, either to obtain a larger amount of the prescribed medication or to change the medication type; or the total forgery of a prescription through theft of a physician's prescription pad or the counterfeiting of a prescription pad. Additionally, in some cases, pharmacists have forged prescriptions to facilitate their ability to procure certain narcotics either for personal use or for resale.

*Product forgery:* also referred as counterfeit goods, this type of forgery involves the manufacture and sale of desired objects (CDs, DVDs, designer clothing, sunglasses, computer software, brand merchandise, computer chips, Rolex watches, insignia hats and shirts, golf clubs, videogames, handbags, etc.) This merchandise is often touted as "real" and results in sales being stolen from manufacturers, and consumers buying substandard goods, albeit at a reduced price.

*Religious artifact forgeries:* involves the forgery of items said to have religious, as well as archeological importance. A recent case (July 2003) involved the "discovery" of the burial box of Jesus' brother James. The item had been valued at over \$1 million until additional research and the discovery of partially completed other forgeries were found at the dealer's home.

*Stamp forgery:* the forgery of philatelic items is a growing industry as the value of certain stamps increase in value. Forged stamps include both domestic and foreign issues. In response to these forgeries, websites such as the "Comparative Stamp Forgery Identification Site" display examples of philatelic forgeries as well as identify some noted forgers.

*Travelers' checks, money orders, cashier checks:* involve the forgery of nonchecking banking instruments. Due to the proliferation of companies offering these services, retail clerks are not always able to identify forged or counterfeit versions.

#### SEE ALSO

art fraud; scams; insurance fraud; bad checks; religious fraud; counterfeiting.

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## France

AN IMPORTANT PROPAGANDA factor in preparing the French Revolution of 1789 was the Diamond Necklace Affair of the 1780s. Although just a trickery (a Cardinal was encouraged by impostors to corrupt Queen Marie-Antoinette with a necklace, which never reached her), it had an immense anti-feudal impact on French society. During the Revolution, corruption and usury of grain or bread dealers and armament suppliers were a constant theme; thus, the young Napoleon Bonaparte gained public favor with get-tough policies against abuse during his first campaign in Italy.

### CORPORATE CRIME

But the golden age of business crime and scandal in France was the Third Republic, especially the years from the 1880s to World War I. Some of the effects from this period are still important today, such as the Panama Canal, projected as comparable to the Suez Canal some years before by the French engineer Ferdinand de Lesseps.

The ambitious plan failed as a French enterprise not necessarily due to technical problems arising from the construction of such a gigantic project (to be finished later by the United States), but due to the corruption of the French political class. When the Panama scandal broke, it had an immense impact on the parliamentary elections of 1893, when the Assembly was purged of all those politicians implicated in the scandal.

During World War I, the subject of war profiteers reappeared. The link between business crime and the republican democracy, installed in France after 1870, was always used by the political enemies of this system to discredit it. The Panama, and

other scandals before 1900, were unsuccessfully used by monarchists to try to get rid of the republic, and an anti-Semitic notion became imminent with the infamous Dreyfus Affair.

In the 1920s more modern fascist organizations, with some elements within the industrialist bourgeoisie, tried to undermine the democratic aspects of the French form of government, whereby anti-Semitic tendencies gained more and more importance. A decisive step was the Stavisky affair in 1933–34, when the bank *Crédit Municipal de Bayonne* collapsed. It turned out that the known swindler, Serge Stavisky, an emigrant of Jewish origin in Russia, was the founder of this bank and had corrupted his entrance to the banking business with gifts to many important politicians. While the affair was investigated, Stavisky died in an incident which was officially labeled as a suicide.

The extreme right gained some public support from this affair and (not only for this reason) tried an unsuccessful coup on February 6, 1934. When, in 1936, the *Front Populaire*, that is, a government of socialists and communists, took office, the extreme right became even more violent. The secret right-wing association, *La Cagoule*, (the Hood) plotted to murder representatives of important associations of employers and to blame the left for such atrocities.

The plan failed, but when Nazi Germany invaded France in May–June 1940, some elements from these right-wing extremist groups slipped into office of the collaborationist administration of France (the Vichy government). Under German supervision, robbery of Jewish property in France started, and French collaborators and German occupiers profited alike.

## POST-WAR BUSINESS

After the liberation of France in 1944–45 by Allied and French troops, the economic system of France changed dramatically. Industrialists like the car and motor manufacturer Renault were expropriated by the new Charles de Gaulle government for its guilt while collaborating with the Nazi invaders. Although France remained a capitalist country, strong planning measures by the government were introduced against former abuses of economic power and, more importantly, for a speedy reconstruction after World War II. This change within the economic system had dramatic consequences for the

development of business crime. Because of the strong link between the bureaucratic and political elite of the state, and the directors of state-owned production facilities, nearly every business scandal became a state affair. This web of state and industry was only untangled during the late 1980s, but the scandals dating from the postwar era still haunt the French political life. The liberal-right President Giscard d'Estaing lost his office to the socialist François Mitterrand in 1981. One reason for this change in the presidency of the republic was due to the fact that D'Estaing was under strong suspicion of having received diamonds as a "private gift" from the self-proclaimed Emperor Bokassa of Central Africa. But this was probably a minor charge compared to the scandals to follow during the 14 Mitterrand years (1981–95).

## THE MITTERRAND YEARS

It started in 1981 as a government alliance of French socialists and communists, but the latter very soon left the government. After a second phase of nationalization of important segments of the economy during the early Mitterrand presidency failed, a liberal-right government under the socialist Mitterrand (called *cohabitation* in French constitutional terms) started a re-privatization program. During this period, many private "deals" regarding state property were done, and the sale of new stocks to the public failed due to an untimely bear market.

Nevertheless, at this point, the idea of public-owned production facilities lost momentum and nationalization gave way to re-privatization. Whereas the blame for the problems and corruption scandals of the re-privatization process was on the liberal-right parties, the socialists up to the prime minister had to answer questions in public and in court for their involvement in an AIDS scandal (known contaminated blood in hospitals was distributed to patients for economic reasons and because of neglect). Strange figures like the Olympic-Marseille soccer club president appeared on the socialist political stage, later to disappear in courtrooms and prison. Mitterrand was heavily involved in the affairs and scandals, but spared from prosecution by immunity while in office, and by dying soon after leaving the presidency.

The last major scandal originating in this period is the Elf-Aquitaine oil company trial, in which the

state-owned industry became a large distributor of bribes inside and outside of France, and became involved in state intelligence matters which were still being investigated in 2003.

Another major event was the Crédit Lyonnais bank scandal in the early 1990s. Prime Minister Pierre Bérégovoy committed suicide immediately after leaving office in 1993, probably because of (unproven) corruption charges against his government. Edith Cresson, another prime minister of the Mitterrand period, was later appointed the French member of the European Commission, and then became the major cause for the resignation of the whole Commission after corruption allegations in 1999. Jacques Chirac, the Gaullist party successor of the socialist Mitterrand to the French presidency, was still dogged by corruption scandals during his nearly 20 years as mayor of Paris.

## ORGANIZED CRIME

Business and organized crime in France have strong regional aspects. The southern parts of France and the island of Corsica have maintained, for generations, a structure which is very similar to the Italian Mafia. Whereas the famous movie, *The French Connection*, even brought it to Hollywood fame, one has to distinguish the continental parts of southern France and Corsica. Southern France is riddled with shadow economies, corruption of local authorities, bribery for any kind of public services, and arson in summertime for speculation purposes that destroys large forest areas every year.

Although members of all political parties were involved in criminal activities, the extreme right especially profited since the 1980s from such events in cities like Toulon and Marseille, only to further such criminal activities when elected to office. In Corsica, the problems are basically the same, but the criminal acts are often declared to be politically motivated by persons seeking the independence of Corsica from France.

In fact, all the forms of violence and criminal acts are the actions of a mafia-like structure, not of an independence movement. The French state has tried for years to solve this problem by an approach linking criminal investigations and political compromise in an autonomous regime in Corsica, but has failed so far, and has committed several ill-conceived undercover operations (burning property of members of the Corsican Mafia, for example).

## SEE ALSO

corruption; Crédit Lyonnais; Stavisky, Serge; World War II.

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## Frankel, Martin (1955–)

MARTIN FRANKEL, A MONEY manager and former stock broker, orchestrated the largest insurance fraud in U.S. history. Frankel took over small insurance companies in several states, using pseudonyms and a variety of front persons and companies, and then stole their assets. He placed large sums of money in Swiss bank accounts, and financed an extravagant lifestyle that included international travel and expensive spending sprees.

Frankel was a Toledo, Ohio native who gained notoriety because of his illicit activities, and also because of his eccentric lifestyle. A stockbroker until he was barred from trading by the Securities and Exchange Commission (SEC) in 1992, Frankel continued in the field, running an unlicensed brokerage firm, Liberty National Securities, Inc. (LNS). In addition to LNS, Frankel ran two other financial fronts, Thunor Trust and the St. Francis of Assisi Foundation, all fronted by prominent figures, lending credibility to the scheme. Thunor Trust was Frankel's key vehicle for taking over insurance companies.

Thunor Trust purchased the companies, and placed the insurance premiums in its supposed investment firm, LNS, at which point Frankel would embezzle the funds. From 1990 to 1999, he took over several small insurance companies and collec-



tively looted over \$200 million in assets. The companies were housed in Oklahoma, Mississippi, Tennessee, Missouri, and Arkansas.

Frankel has been described as “a short, skinny figure with thick Woody Allen-ish eyeglasses” (always worn askew), who was “nebbishy” and “reclusive.” Nevertheless, his ill-gotten wealth allowed him to satisfy his appetite for sado-masochistic sex, courting women, including Eastern European women via the internet and through personal ads to his compound where he would address their material needs in return for favors.

Frankel kept approximately 20 women around the compound, and, in addition to providing them with office “jobs,” he purchased luxury cars and fur coats, and took them on shopping sprees in some of New York’s most fashionable stores. His compound consisted of two mansions located in Greenwich, Connecticut’s backcountry, a remote area of multi-million-dollar estates, woods, and horse trails. The primary property was a \$3 million stone mansion, outfitted with video surveillance cameras, numerous offices, over 80 computers, and large screen televisions to watch various financial news programs. Frankel also owned a fleet of luxury cars in addition to a few private planes, and employed a host of bodyguards.

## ON THE LAM

At some point in late April 1999, Frankel realized authorities would soon unravel his financial conspiracies. He fled to Rome, Italy, on May 5, 1999. Frankel left his workers with hastily drawn orders to shred incriminating documents. Apparently discouraged by the time-consuming shredding process, some of Frankel’s assistants attempted to burn documents.

An automatic alarm called firefighters out to the high-security mansion, where they found a file cabinet ablaze and documents burning in two fireplaces. Among many incriminating documents found by responding firefighters and police officials were a “things-to-do list” that included such items as “launder money” and “Get \$ to Israel get it back in,” and astrological charts designed to answer such questions as: “Will I go to prison?” “Should I leave?” and “Will I be safe?”

Based on these discoveries and subsequent investigations, a warrant was issued for Frankel’s arrest on May 16, 1999. The international manhunt

for Frankel began as Interpol (international police) issued its highest alert (red notice) for him.

After a short stay in Rome, Italy, Frankel left for Germany. He eventually checked into the Hotel Prem in Hamburg under the name of Roger Ellis. His anxiety increased as he read the daily U.S. news coverage of his exploits. One of the female companions who accompanied Frankel on his trip abroad to avoid prosecution eventually feared for her own well-being. She contacted her lawyer in the United States, providing him with explicit instructions to contact authorities regarding Frankel’s location.

## DIAMONDS AND FALSE PASSPORTS

Frankel was arrested on September 4, 1999 in his hotel room by German state and federal police working in conjunction with U.S. Federal Bureau of Investigation (FBI) officials. German authorities charged Frankel with failing to pay import duties on 547 diamonds (net worth \$8 million) and possessing nine false passports (two British and seven Greek). He was convicted on September 20, 2000, and sentenced to three years in a German jail. However, Frankel was soon extradited to the United States in March 2001 to face the more important fraud charges.

Nine of Frankel’s associates pleaded guilty to a variety of racketeering, fraud, and money-laundering charges at the state and federal levels, and a tenth was found guilty in court. In May 2002, Frankel pleaded guilty to 24 federal counts of securities fraud and racketeering, and he later pleaded guilty to numerous charges at the state level. Frankel faced up to 150 years in prison and over \$6.5 million in fines in early 2004 with final sentencing pending.

## SEE ALSO

securities fraud; insurance fraud; racketeering; Securities and Exchange Commission.

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## free enterprise

THE CONCEPT THAT underlies capitalism, free enterprise is the economic system based on private rather than public ownership of the means of production. Investment of capital and employment of labor generate personal profit, which benefits society. According to free enterprise theorists and advocates, economies work best when left free to respond to fluctuations in supply and demand, and government intervention should be limited if not eliminated.

The theory is primarily the work of Adam Smith, who wrote *The Wealth of Nations* in 1776 as a reaction to the then-current philosophy of mercantilism. The profit motive that drives free enterprise has been present in virtually all economies, but its fullest expression came in the 18th century when the Industrial Revolution shifted power to merchants, bankers, and industrialists (sometimes known as the bourgeoisie or middle class) from the traditional landowning elites. The transfer of power came first in Great Britain and it came in all spheres—politics, economics, and society. Free enterprise, in practice, has always required some restraints by government; it does tend toward abuses, including slavery (Great Britain and the United States), apartheid (South Africa), fraud, and monopoly.

Free enterprise capitalism can arise in different social and political systems; it can take the form of democratic socialism, as in Scandinavia, or state-sponsored industrialization, as in South Korea and the Asian states (Malaysia and others.) It can exist under democracies as well as totalitarian regimes.

Free enterprise dominated in the United States during the Gilded Age of rapid and ruthless industrialization in the last decades of the 19th century. And it became excessive again by the 1920s, leading to government restraints after the Great Depression discredited it. The United States, since the 1930s, has provided exemptions, incentives, subsidies, and tax breaks. Other countries, such as Japan and Germany, have centrally planned industrial policies negotiated through meetings of labor, industry, and government at which agreements are negotiated about such things as interest rates and wages.

The former communist states of the late Soviet Union and its satellites shifted from socialism to some form of free market capitalism after the break

up of the Soviet Union between 1989 and 1991. China, late in the 20th century and early in the 21st, shifted its economy to at least a semblance of free enterprise.

Advocates claim that capitalism promotes the well being of all humans. They rely on such advocates as John Locke, Ludwig von Mises, and Ayn Rand. They equate free enterprise with individual freedom from crime, from government oppression, from force. Besides freedom “from,” there is freedom “to.” Freedom to do whatever each person deems to be in his or her own interest: freedom to work where one wants, buy what one wants, keep all that one makes. Freedom to do anything but force another. Free enterprise is presumed to be the source of maximization of use of infinite resources as each free person converts nature into economic goods and wealth. Production improves the environment by rearranging natural chemical elements for human well being. The division of labor allows expansion of the total knowledge by allowing each to learn more about her specialty, and this expanded knowledge benefits all individuals.

Free enterprise allows individuals to rise to their limits, and that creates a hierarchy of merit as identified by David Ricardo and Smith. Free enterprise brings best prices to the market; supply negotiates with demand. Consumer power controls free enterprise by accepting or rejecting the supply and the terms on which it is offered. Competition is benign and forces suppliers to be honest as they compete for finite consumer dollars.

### FREE ENTERPRISE AND FREEDOM

Free enterprise guarantees individual, political, social, and economic freedom. Advocates claim that the economic freedom advocated by the framers of the Constitution gave way to collectivism, with the government controlling distribution of over half the country's output. Milton Friedman wrote that this is contrary to the nation's best interests because the best way to make peoples' lives better is through private markets, and extremely limited government: free enterprise. Free of government, the economy will grow ever larger as free enterprisers seek to maximize their incomes by using their own personal property, physical or intellectual, to give the market what it wants, thereby gaining market share and profits. Economic life is an auction, an exchange in Smith's words, “by mutual consent and to mutual

advantage." Another advantage is that the free market forces moral discipline: the capitalist has no legitimate claim to his wealth unless he also serves mankind. John D. Rockefeller's philanthropy should have gone unnoticed because it was typical free enterprise behavior. Supposedly, the welfare state is immoral because it entitles all persons to the production of the capitalist without obligating them to earn it.

Those less enchanted with free enterprise note that the maximum expression of free enterprise, that of the 19th century, led to *laissez-faire* capitalism which meant dog-eat-dog, cutthroat competition, oppression of workers in sweatshops, government-industry collusion against organized labor, environmental degradation, and exploitation as well as endangerment of the consumer. The abuses of the system by capitalism run amok were such that the people rose in protest, as did the capitalists. Demands for restraints on the free enterprise system resulted in the progressive reforms such as

pure food laws, restrictions on exploitation of labor, and anti-monopoly laws.

Over time, the free enterprisers learned to use government to their advantage, accepting aspects of socialism for the capitalist, if not the consumer. Free enterprise generally has sounded better in theory than it proved to be in practice.

#### SEE ALSO

capitalism; unfair labor practices; antitrust; globalization; United States; United Kingdom.

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# G

## G. D. Searle

WHEN PHARMACEUTICAL giant Monsanto bought struggling rival G. D. Searle for its NutraSweet sugar-substitute patents, it did not expect to become responsible for millions of dollars in product liability related to the Cu-7 intrauterine device (IUD) marketed by Searle in the 1970s.

Due to scares over the long-term health effects of oral contraceptives, IUDs became both popular and profitable in the early 1970s. Although no one is quite sure how IUDs prevent conception—continuous irritation to the uterus preventing fertilized eggs from implanting, is one hypothesis—devices inserted into the uterus had been used since at least the mid-19th century. Each IUD innovation proved to cause serious fertility and health problems, culminating in the Dalkon Shield disaster, after which Searle competitor A. H. Robins declared bankruptcy to minimize product liability claims against it.

Initially, it seemed that Searle had learned from Robins' mistakes. The Cu-7 IUD, so named because it resembled a number 7 wrapped in copper (atomic symbol Cu), was the first IUD to receive premarketing approval from the U.S. Food and Drug Administration (FDA). The IUD was classified as a drug, rather than as a less-regulated device, because part of its contraceptive effectiveness was believed to come from leaching copper into the womb. Ap-

proved in 1974, the Cu-7 was, like the Dalkon Shield, marketed as a safe contraceptive for both multiparous women (those who had borne children) and nulliparous women (those who had never given birth and who therefore had smaller uteruses). During its 12 years on the U.S. market, the Cu-7 reputedly earned Searle more than \$80 million in profits.

On January 31, 1986, Searle announced that it would halt Cu-7 sales in the United States. Planned Parenthood president Fay Wattleton told the Washington Post that she was "dismayed," as her organization had recently reaffirmed its support for IUDs as a safe form of contraception. Women wearing the Cu-7 and another Searle IUD, the Tatum-T, were told there was no reason to have their IUDs removed before their scheduled replacement date. (Searle, unlike Robins, had recommended replacement every three years.)

Two years later, internal Searle documents unsealed at a Minneapolis, Minnesota, trial convinced a jury that company officials had known the Cu-7 was unsafe. Among the evidence was a proposed label that mentioned a "three-to-fivefold increased risk of pelvic inflammatory disease" (PID), particularly for nulliparous women and women under age 25.

PID is a known cause of infertility. By the time the label left the company for FDA approval, it no

longer mentioned the risk level nor strongly recommended against using the IUD in younger women.

Additionally, testimony and documents suggested Searle had known there were defects in the IUD's monofilament string, allowing bacteria to travel up the string to the ordinarily sterile uterus, again causing PID. Although two-thirds of the previous 13,500 Cu-7 suits had been dismissed or settled for small amounts and Searle had won 15 of the 18 that went to court, this time a jury awarded \$8.75 million to plaintiff Esther Kociemba, a nulliparous woman rendered infertile by her Cu-7. The first case to award punitive damages, this one was expected to start a torrent of successful claims against the company.

The NutraSweet business was not without legal difficulties, either. When Searle faced, in 1983, a shortage of vital ingredient L-phenylalanine, it persuaded other firms to invest in production capacity. Two years later, Searle declined to renew its contracts with Purification Engineering and Genex. Genex sued for \$40 million, alleging fraud and racketeering, as it had built a facility to meet Searle's long-term needs. The suit was settled for a nominal amount.

In 1986, Senator Howard Metzenbaum (D-OH) called for investigation of whether Searle had presented incomplete and misleading data to the FDA when seeking approval of aspartame, the generic form of NutraSweet. Some studies suggest the sugar substitute causes brain tumors. Metzenbaum referred to the findings of a 1975 task force that examined Searle's handling of aspartame and blood pressure medicine Aldactone. That task force concluded that data submitted by Searle to the FDA was unreliable. NutraSweet remains a popular artificial sweetener.

#### SEE ALSO

A. H. Robins; Food and Drug Administration; Dalkon Shield; advertising fraud.

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## gambling and lotteries

SECOND TO THE ILLEGAL trade in drugs, gambling and its ancillary crimes are a major source of income for organized-crime operations, which often spill over into white-collar crime. Organized-crime enterprises, from La Cosa Nostra to the Yakuza, rely heavily on gambling as a core operation, producing revenue on an ongoing basis.

The gambling operations lead to other aspects of their enterprise, such as loan-sharking and extortion. Gambling is best described as the opportunity to wager on some action in anticipation of correctly selecting the winner and receiving compensation in return.

Illegal gambling may exist in many forms and formats but is described by the United States Government in Title 18, U.S.C. Sec. 1955 as a business that: 1) is a violation of the law in the state in which it is conducted; 2) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and 3) has been or remains in substantially continuous operation for a period in excess of 30 days, or has gross revenues of \$2,000 in any single day.

The introduction of legal gambling opportunities (casinos, state lotteries, video poker, internet gambling, and legal sports betting) has not dried up the demand for illegal gambling operations. The continued success of illegal gambling operations may be due to the convenience factor, the higher odds, the absence of reporting to the Internal Revenue Service (IRS), the availability of credit, and the number of sporting events on which bets can be placed.

Proceeds from illegal gambling have in the past been associated with public corruption. In many cases public law enforcement officials have accepted payments from illegal gambling groups to operate. Recently, the governor of Louisiana was convicted on federal charges concerning corruption, some re-

lated to gambling. Some of the common operations are described below.

## LOTTERIES

The involvement of organized crime in gambling and lottery operations dates back to the early years of America during colonial days. A private lottery passed by Congress in 1823 for a beautification campaign in Washington, D.C., was never paid out when the organizers fled with the proceeds. As more and more states outlawed lotteries in the 1800s, smugglers began transporting tickets from legal states to outlawed states where the demand was still present.

The Louisiana lottery was an example of the fraudulent underpinnings of the lottery system. It was discovered that the lottery syndicate operating the state lottery was actually a criminal syndicate from New York, which had skimmed winnings off ticket purchases and had paid multiple bribes to state legislators to maintain their state contract. Other state lotteries were exposed for fraudulent activities, such as a New York lottery manager who promised to pull certain tickets so they could not win, and the fact that he “owned” a percentage of any winning ticket.

With the eventual prohibition of state lotteries, illegal lotteries began to appear. Eventually, public lotteries reappeared as funding devices for states, but in the interim, organized crime created the numbers or policy racket to satisfy the appetite of gamblers who either desired the action gambling provided or the chance to cash in. Organized crime has attempted to remain in the legal lottery business by attempting to enter the business of supplying lottery terminal and affiliated services to state governments.

## NUMBERS RACKET

The numbers or policy racket grew out of the lottery games; due to the ever-increasing cost of tickets. Some tickets prices were topping \$60 in times when annual incomes seldom reached \$1,000. Policy betting allowed poorer people to participate in the game by allowing the purchases of tickets by selecting particular numbers that would be picked in the lottery on any given day. The game was not connected with the lottery and the winnings were determined on the number of bets made.

The lottery industry attempted to maintain pace with the policy games, but more bettors preferred the policy game, where drawings could be observed daily and runners came by to pay off bets. In the 1920s, the numbers racket took form, starting as a game in which a three-digit number (000–999) was selected as the winner; with the number originally being the last three digits of the daily U.S. Treasury Balance, attendance at the local track, stock market sales for the day—any number that could be viewed by large numbers of people and a number that allegedly could not be tampered with. The game thrived in poorer communities and eventually organized crime saw the value of the game. Dutch Schultz took over the numbers/policy racket in Harlem, New York City, in the 1920s while Al Capone financed much of the numbers racket in Chicago, Illinois.

The numbers racket is still viable in many U.S. cities with most operations being run out of legitimate businesses, including bars, newspaper stands, and small retail shops. The Charleston, South Carolina, police estimate that several suspected numbers games in their city take in at least \$60,000 each daily, sometimes using the legal state lottery numbers as their winning numbers. Some research has alleged that the revenue generated from illegal number operations exceeds the amount of revenue generated by state operated lotteries.

The game is organized so that persons taking the bets can “layoff” (sell or trade certain blocks of tickets) to other betting operations if one number is being selected out of proportion to the other numbers. As with most organized criminal enterprises, there is a specialization of positions within the numbers operation, that is, runners who collect bets and make payoffs, bankers who handle the cash, and operators who make sure that the operation runs smoothly, sometimes through bribes to local officials.

## BOOKMAKING/SPORTS BETTING

Bookmaking often refers to the acceptance of bets on sporting events, which is generally understood to be illegal except in some licensed casinos. Illegal sports betting operations, referred to as bookies or bookmaking, will accept wagers on most sporting events, including professional and collegiate football, basketball, baseball, as well as horse races, tennis matches, and almost any athletic event.

A gambler wagers a bet through her bookie, placing either single bets (selecting a certain time to win or lose) or placing a series of bets (parleys, "if bets," secondary bets contingent on outcome of first bet, for example, scores at the end of certain periods in a game, etc.). Often bets are made on the outcome of the game (who won or loss) but by how many points, or the point spread. If the bettor wins she is paid the amount she wagered; if the bettor loses she owes the amount wagered plus 10 percent.

Illegal bookmaking has often raised allegations of games or races being fixed, in which players are instructed to shave (reduce the number of points they normally score) points, or throw (intentionally lose the game) the game. The advance knowledge of the final outcome of a sporting event, not the exact score necessarily, but who would win and how close the margin would be, allows bettors or bookies to wager differently on those games. These types of allegations have existed throughout sporting history as noted by the 1919 Black Sox Scandal in which several Chicago White Sox players allegedly accepted money to influence their play.

College basketball scandals occurred at both Boston College and Tulane University, with allegations of point-shaving at both colleges. Pete Rose, formerly of the Cincinnati Reds Major League Baseball (MLB) team was banned from involvement in MLB for life due to his involvement in placing illegal bets of MLB games, which he admitted to in 2004. One concern for illegal sports-betting analysts is that players who owe sums of money to those illegal operations may throw games to help reduce their debts, either by betting against themselves or by agreeing to throw the game for a third party.

Illegal bookmaking operations are found in almost all major U.S. cities, with most being completely operated or funded by organized criminal enterprises. The involvement of organized crime is sometimes needed in illegal bookmaking operations to "lay off" bets, a situation in which too much money is being wagered on a certain outcome (Team A to beat Team B). If the operator accepts all those bets on Team A and the team wins, he will not be able to pay all the winners. Through the use of a lay off, the excess wagers on Team A are traded/sold to another bookmaking operation, who may be experiencing an increase of bets on Team B.

One of the conveniences of illegal bookmaking is the ability to play on credit, not having to pay

until after the game. This convenience often leads to another negative aspect of illegal gambling: loan sharking. In some criminal enterprises, the focus is the profits generated by loan-sharking not from the bookmaking operation.

## LOAN SHARKING

Organized criminal operations will loan funds to bettors who may not necessarily be able to secure other funding, especially if the purpose of the money is to gamble. However, the interest rates charged by organized crime operations are generally usurious, many times higher than the amount allowed by law. In some cases, bettors can barely afford the weekly interest, often called the vig or the nut, which sometimes approaches 20 percent weekly, with the principal never being reduced. Organized crime operations may sometimes utilize violence to collect the funds or proceed to secure payments in other manners: taking ownership in the bettor's business, obtaining confidential information the bettor may have access to (police records, alarm codes, shipping information, inside stock information, etc.) or securing the bettor's involvement in a criminal event (throwing a sporting event, assist in drug trafficking, or being a collusive victim in a crime such as a staged robbery).

## PRIVATE CLUBS

In some areas, gambling operations are run as private clubs in which there is no state oversight, as the "house" operates the club, controls the odds, the payouts, and the legitimacy of the games. These private clubs offer the same games of chance as do legal casinos, but often these clubs involve high stakes games that attract players who prefer their anonymity or the fact that no taxes are paid on the winnings.

Additionally, these clubs may offer courtesies not generally available at legal casinos: extended credit, no-limit betting, drugs, and prostitution. In the early days of gambling some clubs may have been involved in "rigging" (affecting the outcome of a game of chance), but most operations now focus on the profits made from the operations from interest on loans, sale of drugs, and repeat visits by high-cash players. The house "takes a cut" (receives a percentage of each card hand played, for example) of all the gambling action. Similar to the speakeasy

days of Prohibition, patrons do not see themselves as criminal and may not understand the connection between the club and organized crime.

### CASINOS

As seen in many organized-crime movies, casino operations were heavily impacted by organized crime. The creation of Las Vegas, Nevada, provided organized crime an operation by which money could both be made and laundered (providing a source of origin for the proceeds generated through illegal operations). With years of experience in the gambling industry, large amounts of working capital, and loyal (to the operation) workers, organized crime was able to establish a foothold in the casinos of Las Vegas.

Due to tremendous amount of cash that passed through casinos, organized crime groups were able to skim, removing money from the daily receipts before it was entered into the accounting ledgers) and yielding large amounts of tax-free money. Additionally, through the use of labor extortion, physical violence, and blackmail, organized criminal operations were able to impact non-gambling aspects of casino operations, including hotel/casino line employees, linen and food delivery, construction, and financing. Through the use of bribes and other methods, organized criminal operations were able to conduct other activities (prostitution, drugs, loan sharking) at the casinos. In some cases, covert operations would be conducted against non-affiliated casinos, such as setting up rigged games, thefts, labor strife, and vandalism.

Organized crime influence is not confined to Las Vegas casinos, as has been noted in several licensure hearings of non-Nevada casinos. Casino hearings in Illinois, Louisiana, Minnesota, and Missouri have disclosed the presence of organized crime members in the "management" groups attempting to secure casino permits. The Senate Select Committee on Indian Affairs similarly noted several attempts by persons with organized-crime ties trying to gain influence in Indian casino operations.

### INTERNET/OFFSHORE GAMBLING

Internet gambling has provided bettors the opportunity to place bets through computers, bypassing domestic anti-gambling laws, as the bets are processed through offshore accounts. Persons with internet access and a valid credit card account num-

ber can wager on multiple games of chance and sporting events. Since the operations are not regulated normally, no dollar limits exist, other than the amount of credit available on the bettor's credit card. This gambling type is just as addictive as other types of betting, and some reports indicate that it may be more addictive. In March 2003, a former executive and president of Conbraco, Inc., pled guilty to wire and bank fraud charges which resulted from an attempt to cover \$31 million in internet gambling losses in a one-year period. The betting transactions are processed through credit cards, and some of the processors are organized crime operations that then compromise the credit of bettors.

### HORSERACING, PARIMUTUEL BETTING

While the numbers racket is assumed to generate large amounts of illegal profits for organized crime operations, it relies on a multitude of transactions as the price per ticket is low. Gambling on horses however, can produce large amounts of revenue on a limited number of bets. To generate the large amount of daily legal bets that the horseracing industry needs to remain profitable, parimutuel betting was developed. Parimutuel betting is a process by which all bets on all horses are recorded at the time the ticket is printed, that is, the bet is made; and the payoff odds as well as the amounts that can be paid-out are determined.

Betting on horseraces was further supplemented by the acceptance of off-track-betting, betting that does not require the bettor to physically be at the racetrack in question. Racetracks, in an attempt to attract patrons physically to the racetrack, have introduced video poker machines, gambling devices that allow bettors to replicate the motions of playing poker at casinos. Betting on horseracing has sometimes been impacted by organized crime's attempts to fix races (controlling the outcome of a race). Races have been fixed through various methods, including: medication of horses, bribes to jockeys, substitution of horses, and threats of violence. Other crimes that link gambling and organized crime include insurance fraud through the murders of highly insured horses.

### VIDEO POKER

Some states have legalized gaming (a newer, more innocent term for legalized gambling) in their jurisdic-



tions as a tax-generation device, ranging from casinos to video poker terminals in convenience stores. The terminals are leased from licensed supply companies and installed in various businesses: bars, restaurants, and liquors retailers. The video poker terminals allow bettors to play electronic poker hands against the terminal. The integrity of the game is guaranteed by a state agency, charged also with approving licenses for owners, operators, and financial sources for the supply companies. In some cases, organized crime groups have been able to obtain licenses and enter the business. Once licensed, these groups sometime pressure potential customers to use their terminals and not those of the competition. Some instances have been found where terminals had been tampered with, to allow for the winning hands to be pre-determined.

#### SEE ALSO

organized crime; Cuba; Capone, Al; insurance fraud; federal gambling regulation.

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## Geis, Gilbert (1925–)

THE PUBLICATION of “The Heavy Electric Equipment Antitrust Case of 1961,” authored by Gilbert Geis, engendered future generations to the study of white-collar crime. The price-fixing case, first published in 1967 in Marshall Clinard’s and Richard Quinney’s *Criminal Behavior Systems: A Typology*, represented a significant landmark in expo-

rations of deviant corporate practices during a time period in which academic interests in white-collar crime had become somewhat complacent. The conduct of some corporate officials, including high-ranking General Electric and Westinghouse Electric executives, was accurately characterized by Geis as flagrant criminal offenses that violated the Sherman Antitrust Act of 1890. The research illustrated corporate crime by numerous individuals who participated in a price-fixing conspiracy.

Ultimately, grand juries issued 20 indictments for 45 persons and 29 corporations. The majority of defendants entered a guilty plea resulting in fines of almost \$2 million and seven convictions with jail terms of 30 days, with time off for good behavior. Geis takes note of the lenient sanctions afforded the offenders: for GE a half-million-dollar loss was no more punitive than a \$3 parking fine to a person with an annual income of \$175,000. The case study methodology offered insights into the specific nature, techniques, and offender characteristics involved in widespread corporate deviance that supported and refuted many of the observations and insights first offered by white-collar crime pioneer Edwin H. Sutherland.

Geis, considered one of the most influential white-collar-crime scholars since Sutherland, was born in New York City. He was raised in Brooklyn by his mother and grandmother and partially credits his interest in criminology to the latter’s fervor for dime crime magazines. Note might be made also that his grandmother, a Polish immigrant, supported the family during the Depression by manufacturing bootleg liquor that was marketed through the Dutch Schultz gang. After a short stint in the U.S. Navy as a radioman second class and first-class ping-pong player during World War II, Geis continued his education at Colgate University.

From 1946 to 1948 he worked as a reporter for the *Times* in Hartford, Connecticut, and then the *Daily Home News* in New Brunswick, New Jersey. He received his Master’s degree from Brigham Young University in 1949 and his Ph.D. from the University of Wisconsin, Madison, in 1953. He recalls first reading Sutherland’s *White Collar Crime* in 1952 during his tenure in the department of sociology at the University of Oklahoma.

He describes these five years as an uneasy exile in uncharted geographical and academic territories that required him to teach courses in criminology and race relations, though his majors had been Eng-

lish and journalism. His little-known mystery novel about a rape on a college campus, *Fury on Legs*, was written during the summer while he was teaching at Adams State College in Alamosa, Colorado. In 1957, he left Oklahoma to teach at California State University, Los Angeles. He then joined the school of social ecology at the University of California, Irvine, in 1971 and became a professor emeritus in 1987.

The breadth and depth of Geis's academic career is legendary. He has published more than 384 journal articles and books dealing with a whole host of topics: juvenile delinquency, victimless crime, witches, corrections, racism, courts, death penalty, courtship, policing, victimization, rape, gangs, Leopold and Loeb, Charles Manson, and O.J. Simpson, to name a few. Geis's first white-collar publication in 1962 grappled with the delineation of white-collar crime offenses, and since 1967, he has explored numerous subjects in the area, including deterrence in corporate crime, victimization patterns, theoretical explanations, medical and health-care fraud, perceptions of seriousness, and sanctions.

Geis has been the recipient of many awards, including, for example, the Edwin H. Sutherland Award for Outstanding Contributions, the Donald R. Cressey Award for Excellence in Fraud Detection and Deterrence, and scores of outstanding and distinguished professor awards. He has served as president for the American Society of Criminology, president of the Institute for Financial Crime Prevention, chair of the subcommittee on white-collar crime for the American Bar Association, and member of the advisory committee for the National White-Collar Crime Center.

#### SEE ALSO

Sutherland, Edwin H.; Clinard, Marshall; Cressey, Donald; differential association; self-control theory; Pontell, Henry N.; Great Electrical Equipment Conspiracy.

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## gender discrimination

SEXISM IS AN IDEOLOGY that suggests one sex is inherently superior to the other. Such beliefs support gender prejudice (attitudes) and gender discrimination (actions that perpetuate differences in hiring, promotion, and pay). Sex discrimination exists in various forms, and women aren't always the victims: about 10 percent of complaints filed come from men.

Sex discrimination occurs when people are treated differently because of their gender. Examples of discrimination can involve pay disparity, hiring and firing, promotions, sexual harassment, and pregnancy.

Equality for American women made significant gains in the latter part of the 20th century, including legal pressure for equal pay for comparable work, greater access to traditionally male dominated jobs, and changes in the law to discourage sexual harassment. Men have also benefited from these laws. The following laws have reduced discrimination based on sex:

The 1963 Equal Pay Act (EPA) protects men and women performing essentially equal work in the same establishment from wage-based discrimination. The EPA covers all employers who are covered by the Federal Wage and Hour Law (the Fair Labor Standards Act). Virtually all employers are subject to the provisions of this act.

Title VII of the Civil Rights Act of 1964 prohibits employment discrimination based on race, color, religion, sex, or national origin. Title VII covers all private employers, state and local governments, and education institutions that employ 15 or more individuals. These laws also cover private and public employment agencies, labor organizations, and joint labor management committees controlling trade apprenticeship and training. The Civil Rights Act of 1991 provides monetary damages in cases of intentional employment discrimination.

The U.S. Equal Employment Opportunity Commission (EEOC) is in charge of enforcing

many of these laws. EEOC also provides oversight and coordination of all federal equal employment opportunity regulations, practices, and policies. Legally, it is up to employers to stop sex discrimination, explains Brad Seligman, anti-discrimination attorney. "Under federal law, there is no liability for a supervisor who discriminates, but a supervisor's conduct results in the employer being responsible. The buck stops with the employer. As a practical matter, employers who don't control discrimination in their workplace can face draconian consequences." The sex discrimination suits Seligman has pursued "have netted victims \$107 million from the Lucky store chain and \$250 million from State Farm Insurance."

Any individual who believes that his or her employment rights have been violated may file a charge of discrimination with EEOC. In addition, an individual, organization, or agency may file a charge on behalf of another person in order to protect the aggrieved person's identity. The "relief" or remedies available for employment discrimination, whether caused by intentional acts or by practices that have a discriminatory effect, may include: back pay, hir-

ing, promotion, reinstatement, front pay, reasonable accommodation, or other actions that will make an individual "whole" (in the condition he would have been but for the discrimination). Remedies may include payment of attorneys' fees, expert witness fees, and court costs.

Under most EEOC-enforced laws, compensatory and punitive damages also may be available where intentional discrimination is found. Damages may be available to compensate for actual monetary losses, for future monetary losses, and for mental anguish and inconvenience. Punitive damages also may be available if an employer acted with malice or reckless indifference. Punitive damages are not available against the federal, state or local governments. More than 20,000 sex discrimination complaints per year were filed with the EEOC during the 1990s, not including charges made to state governments. Damages awarded through the EEOC totaled \$81 million in 1999.

#### SEE ALSO

workplace violence; employee safety; age discrimination; racial discrimination.

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*Gender discrimination against women may involve hiring and firing, promotions, sexual harassment, and pregnancy.*

## General Dynamics

GENERAL DYNAMICS Corporation, a St. Louis, Missouri-based defense contractor, is alleged to have defrauded the U.S. government by inflating costs, understating profits, and committing contract fraud by offering kickbacks in connection with a 1970s-era shipbuilding contract.

In 1985, government prosecutors charged the firm with criminal fraud stemming from early development work for a U.S. Army air-defense gun system, known as the Division Air Defense weapon (Divad). The allegations combined to make General

Dynamics into a symbol of the problems with military procurement.

In the late 1970s, the U.S. government offered a subsidy program to make American companies more competitive with foreign shipbuilders. The government later claimed that Quincy Shipbuilding division of General Dynamics fabricated an estimate that was designed solely for the purpose of winning an \$80 million subsidy. The subsidy allowed a profit of only 10 percent on the ships, but General Dynamics' actual profit was about three times that amount.

The government complaint, brought against the contractor in 1987, charged that the firm kept two sets of books for the building of the ships, which were used to carry liquefied natural gas. One set of books accurately portrayed the company's costs and profit projections. But the other set of books were based on widely inflated costs, misleading estimates and illegal kickbacks received by General Dynamic's officials for subcontracting work. General Dynamics, however, claimed that it was being penalized for setting overly optimistic goals for its work on the ships.

The company insisted that the supposedly secret set of books were merely estimates for an operating plan, and not hard figures reflecting costs and profits on the ships.

In 1991, the federal government attempted to recover \$240 million by suing General Dynamics and four of its employees in a New York federal court. The sum included the \$80 million subsidy as well as an additional \$160 million in penalties. The government alleged that the kickbacks had inflated the amount of subsidies by \$7 million. The Department of Justice later dropped the suit. In 1996, the government was ordered to pay the firm \$25 million for legal fees incurred during the pursuit of the case.

General Dynamics is also alleged to have committed fraud in the 1980s by illegally billing the Pentagon for cost overruns related to the \$5 billion Divad project. General Dynamics was briefly barred from bidding on defense contracts as a result of the charges. Under the direction of Defense Secretary Caspar Weinberger, the navy ended General Dynamic's suspension from new government contracts in 1986, and stirred controversy by promising that the government would never again suspend the company for any subsequent indictments involving its earlier activities. Generally, an indictment brings

an automatic suspension from new contracts. The criminal action was subsequently withdrawn by the Justice Department.

#### SEE ALSO

kickbacks; bribery; government contract fraud; corruption; government procurement fraud.

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## General Electric

GENERAL ELECTRIC (GE) is a massive multinational conglomerate, with 107 factories in the United States and 103 overseas plants in 23 foreign nations. It employs 243,000 American workers and has about 500,000 stockholders. About 300 major retail stores use its credit card system, and its NBC television network has about 200 affiliate stations in the United States.

General Electric is the third-largest defense contractor, and the nation's second-largest plastics manufacturer, the owner of RCA, has its own cable television network, and is a stockbroker (it owns Kidder Peabody). Moreover, it has its own bank, GE Capital, which has \$91 billion in assets. General Electric is also among the most lawless of American corporations. For example:

1957–61. GE was convicted of price-fixing and other charges for electrical equipment valued at \$1.74 billion per year, the largest price-fixing case in the history of the Sherman Antitrust Act to that time.

1988. GE was indicted on 317 counts of fraud in connection with a scheme to defraud the U.S. Army of \$21 million on a logistics computer contract.

Indeed, GE has a very long history of corporate crime. Other examples include:

1981. GE was convicted of paying a \$1.25 million bribe to a Puerto Rican official to obtain an electrical plant contract. Three GE executives were imprisoned in the case.

1986. GE officials at a machine tool company were charged with providing kickbacks to three former GE purchasing employees to obtain Pentagon subcontracts.

1987. It was exposed that GE supplied thousands of defective military and civilians airplane engines to customers. The defects included cracks in tubing and brackets in the F-404 engine used in the F-18 Navy fighter, the T-700 helicopter, and the CT-7 for small commuter planes.

GE's stock brokerage firm, Kidder Peabody, paid \$25.3 million to settle an insider-trading complaint with the Securities and Exchange Commission (SEC). GE Capital paid a \$275,000 civil penalty in 1989 for discriminating against low-income consumers, the largest fine ever under the Equal Credit Opportunity Act. GE paid a \$32 million settlement to women and minorities in an employment discrimination case, and its Canadian subsidiary was convicted (along with Westinghouse and other firms) of conspiring to fix prices on light bulbs.

GE is also a major environmental polluter. Four of its factories are on the Environmental Protection Agency's (EPA) list of the most dangerous industrial sources of toxic air pollution, and GE has been identified as responsible for contributing to the damage of 47 sites in need of environmental clean up. The company has also paid tens of millions of dollars in out-of-court settlements for its toxic dumping of chemicals.

In the early 1990s, problems including bribery and mis-pricing became so pervasive that the Pentagon's Defense Contract Management Agency took the unique step of setting up a special investigations office just for GE. The office secured 22 criminal indictments against the company, its sub-contractors and employees, and recovered \$221.7 million in fines and settlements.

Between 1990 and 2002, GE has been involved in 63 cases brought by the federal government against it, and has settled claims for \$982.9 million, more than any other corporation in America.

If GE were an individual, it would be considered an habitual criminal under American law. Instead, it tries to undo laws and cultivate a favorable public image by engaging in a host of image-making

and philanthropic activities, including scholarships for poor and minority college students and donations to the United Way. Even charitable contributions further GE's political and economic aims. Some of GE's tax-exempt contributions go to Chris Walker's American Council for Capital Formation (an "educational" front group that campaigns against the corporate income tax and for a national sales tax), the Institute for International Economics (a think tank promoting pro-corporate positions on economic policy and trade), and Americans for Generational Equity (which campaigns for issues like reducing Social Security entitlements).

GE also funds other causes promoting political socialization and propaganda, including membership in the Business Roundtable, whose policy-formation activities disseminate the views of the largest 500 American corporations.

#### SEE ALSO

water pollution; hazardous waste; corporate criminal liability; Kidder, Peabody; corruption; bribery.

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## General Motors

WHEN DRIVERS and passengers enter automobiles, they want to believe that the manufacturer of that particular vehicle has made it as safe as possible. They know their lives might depend on safety measures such as seat restraints, air bags, shatter-proof windshields, and flexible steering wheels. Few drivers even consider that the way in which a car is designed may save their lives. General Motors (GM) makes billions of dollars a year by selling vehicles, and most consumers trust these purchases.

However, before the consumer movement of the 1960s, GM, like other automobile manufactur-

ers, allowed increased profits to take precedence over consumer safety. Even after federal law forced manufacturer responsibility on the automobile industry, design flaws continued to surface, albeit with less frequency.

The driving force behind the move toward greater automobile manufacturer responsibility began in the 1960s when a young, inexperienced lawyer took on the automobile industry, and changed that industry forever. In 1965, Ralph Nader targeted General Motors in his book, *Unsafe at Any Speed*, which the *San Francisco Chronicle* called the *Silent Spring* (invoking Rachel Carson's groundbreaking environmental work) of the automobile industry. Evidently, GM retaliated by trying to discredit Nader. GM allegedly resorted to setting up seduction schemes that were intended to provide grounds for blackmail. When that failed, GM responded by hiring two detectives to follow Nader around hoping to catch him in some wrongdoing.

Nader responded by suing General Motors for invasion of privacy and emotional distress. He used the \$424,000 settlement from *Ralph Nader v. General Motors* to establish a consumer group that provided "continuous legal monitoring" of the automobile giant. The press had a field day with the coverage, and GM's admission of guilt made the front page of newspapers around the country. A Senate subcommittee forced the president of General Motors to apologize for the behavior.

In *Unsafe at Any Speed*, Nader pointed out that based on 1965 predictions by the Department of Commerce, 51,000 people would die in automobile accidents in the United States within the next 10 years. Nader set out to investigate particular automobiles that were contributing to the high number of fatalities, and to discover ways to make automobiles as safe as possible. Nader's investigations revealed that the automobile industry was concerned with profits even when company executives were aware that consumers were at risk.

## THE CHEVROLET CORVAIR

For example, in a keynote speech before the National Safety Congress on October 17, 1961, John F. Gordon, the head of General Motors, insisted that only "amateur engineers" believed the unrealistic idea that automobiles could be made "virtually foolproof and crashproof." At the time that Gordon was ridiculing the notion of safer automobiles,

GM had already paid \$70,000 to Rose Pierini who had filed suit against the company after losing an arm when her 1961 Chevrolet Corvair went out of control and turned over.

Investigators in Pierini's case tried to determine why the Corvair went out of control instead of automatically placing the guilt on Pierini, as had been done in earlier accidents. A witness who had been going in the opposite direction testified in court that Pierini was obeying the speed limit of 35 per hour when her car suddenly veered to the right before turning over. An observant police officer noticed that her tires had made gauge marks, and that the left rear tire was completely deflated, a pattern he had seen in other automobile accidents involving the Chevrolet Corvair. As subsequent information on the Corvair surfaced, it was revealed that law officers around the country had also observed a number of accidents involving the Corvair, all with the patterns similar to those in the Pierini case.

During the Pierini trial, the Chevrolet dealer from whom Pierini purchased her car testified that he sold an accessory that could be attached underneath the Corvair to prevent the caving in or tuck-under that often occurred when the vehicle's rear wheels were put under stress during cornering. It developed that General Motors had manufactured a 696 option that could be sold to Corvair purchasers who were knowledgeable enough to request it. The purpose of the option was to stabilize the rear end with heavier suspension springs, shock absorbers, and a front-end stabilizing bar. Testimony revealed that because of high demand for corrective measures on the Corvair, dealers did not always receive safety parts that were ordered from General Motors.

Within the next few years, over a hundred more lawsuits were filed by owners of 1960 to 1963 models of Corvair, involving millions of dollars in damages. GM consistently blamed bad driving for the accidents and refused to acknowledge any responsibility for a faulty design. As more information surfaced, it became clear that a number of people, including competitors, had known about the problems with the Corvair before accidents started to happen. For example, in 1959, when two test drivers for Ford tried the Corvair, both drivers lost control and crashed. Confidential papers distributed among GM executives revealed that the company was well aware that tuck-under could occur in the Corvair with no warning if a tire skidded side-

ways, was assailed by crosswinds, or when navigating S-curves.

The U.S. Congress passed the National Traffic and Motor Vehicle Safety Act in 1966, mandating the incorporation of safety devices that were designed to prevent as many fatalities as possible in automobile accidents. The act also established the National Highway Traffic Safety Administration (NHTSA) under the Department of Transportation to oversee safety and consumer programs, including motor-vehicle crash testing and automotive recalls. From 1966 to 1972, the death rate from automobile accidents declined an average of 3.5 percent a year.

In *Larsen v. GM* in 1968, the court agreed that GM should have been able to predict that cars were likely to be involved in collisions and should have allowed for that possibility in the design of its vehicles. Larson was one of a number of Corvair drivers who had been injured when his steering wheel became displaced during an accident, causing extensive head damage from the steering wheel rather than from the crash.

#### OTHER DEFECTIVE PRODUCTS

Even in the midst of a number of high-profile lawsuits against General Motors, the company continued to measure customer safety according to a cost-benefit analysis. While the company admitted that customers should not be used as guinea pigs to test various GM designs, executives bemoaned the fact that the automobile industry should still police itself.

This kind of reasoning was evident in a 1979 lawsuit in which General Motors was forced to pay a \$4.9 billion settlement in a lawsuit in which six people had been horribly burned in a rear-end collision of a Chevrolet Malibu. Testimony revealed that GM executives had determined that it was cheaper to settle lawsuits than to change the design of the vehicle.

In the course of various lawsuits, information also surfaced that doors in GM cars were more likely to be torn off during accidents than in cars made by either Ford or Chrysler. Lawsuits were also filed over ignition switches that stuck. GM was taken to task for windshields that shattered during crashes and for instrument panels that turned into deadly weapons when GM cars were involved in crashes. Even after other automobile companies made seatbelts standard equipment, GM had opposed them,

arguing that they only made drivers aware of their own mortality.

A number of successful lawsuits against GM in the 1980s forced the company to discontinue a faulty windshield design that had caused problems with safety restraints. Suits in Arizona and Illinois in the 1990s that involved collapsing seatbelts forced GM to establish more realistic seatbelt standards. In a Georgia case in 1991, GM was sued when the fuel tank of a pickup caught fire after a collision. A GM consultant testified in court that the design of the fuel tank was faulty. A successful lawsuit in Alabama in 1996 resulted in corrections to the design of GM Type III door latch.

The litany of defects, sometimes fatal, continued unabated through the turn of the century as truck-based sport-utility vehicles (SUVs) captured the market, introducing widespread roll-over accidents. The lawsuits continued as well.

#### SEE ALSO

automobiles; Corvair; Nader, Ralph; *Unsafe at Any Speed*; National Highway Traffic Safety Act.

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## Georgia-Pacific

WHILE GEORGIA-Pacific Corporation's 1991 fine for tax evasion set an Atlanta, Georgia, record for corporate criminal penalties, its use of asbestos posed larger problems for this forest products company and its former customers. In October 1991, Georgia-Pacific pled guilty to tax evasion, promising to pay \$21 million in fines and back taxes.

In 1984, the company had claimed a \$24 million charitable contribution when it donated the 5,360-

acre Santa Fe, New Mexico, swamp to the Suwannee River Water Management District. The value of the land was approximately \$2 million.

More significant is the sum of \$181 million that Georgia-Pacific paid for asbestos-related litigation in 2002. An investigative series by the company's hometown newspaper, the *Atlanta Journal and Constitution*, revealed that, although the company knew by 1970 about the dangers of asbestos in its popular Ready-Mix joint compound, it kept the product on the market until 1977. Asbestos, a long-fibered mineral, was essential to the compound's ability to cling to drywall. When an asbestos-free version failed to sell in 1973, Georgia-Pacific put the original version back on the market.

The dangers of asbestos had been known within the industry, though concealed from federal regulators, since the 1940s. In the early 1970s, the Occupational Safety and Health Administration (OSHA) began to demand that factories like Georgia-Pacific's dusty Akron, New York, Ready-Mix plant add ventilation and other protections for workers. In 1973, a study showed that construction workers were also at risk from asbestos. These risks were shared by home do-it-yourself remodelers as well.

The most dramatic health hazard from asbestos exposure is malignant mesothelioma, a rare cancer that attacks the lining of the lungs and heart. Initial symptoms, explains the Mesothelioma Network, may be similar to pneumonia. The *Journal and Constitution* notes that Lisa Pransky, who obtained a \$9 million judgment from Georgia-Pacific, died within three years of diagnosis despite aggressive treatment. Like many victims, Pransky did not show symptoms until 25 years after exposure to asbestos in the Ready-Mix her father used in remodeling the family home.

More than 314,000 asbestos-related claims had been filed against Georgia-Pacific by 2002, with another 29,500 in the first quarter of 2003. The company's appeal as a legal target increased as other asbestos-using firms have avoided settlements by declaring bankruptcy. In late 2002, the company's credit rating slid toward "junk bond" status. In 2003, Georgia-Pacific confirmed rumors that it intended to shelter its other operations from liability.

#### SEE ALSO

asbestos; Johns-Manville, employee safety; workplace deaths; Occupational Safety and Health Act.

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## Germany

WHEN THE Deutsche Reich (German Empire) was created at Versailles near Paris, France, in 1871, a period of economic boom followed, which was called *Gruenderjahre* (founding years). Although business scandals riddled this period, business crime as a major public issue arose only during World War I, when *Kriegsgewinnler* (profiteers of war) became an issue.

The rise of Nazism was closely linked to business interests by great landowners and big business alike. Whereas the agrarian lobby searched for public funds to pay for their immense debts, German industrialists, especially from the heavy-industry Ruhr area supported Adolf Hitler financially to get rid of socialists, unionists, and communists. This alliance formed in the late 1920s and 1930s led to an organized circle of the industrial friends of the SS secret police, and the building of factories to be staffed by concentration-camp inmates.

The SS was not only an instrument of terror, but also an economic entity. The military occupation of most of continental Europe was always followed by economic plunder on a large scale: gold and foreign currency taken from the national banks of the occupied countries, transfer of art treasures to German museums or collections of high-ranking Nazi officials, gaining control and/or expropriation of industries in the occupied countries by German trusts.

The Nazi extermination measures used against the Jews are interpreted by some historians not only



as racial genocide, but as an operation of theft and robbery of a unknown scale accompanied by mass murder.

### POST-NAZI BUSINESS CRIME

After the collapse of Nazi Germany, the Allies investigated business involvement in mass murder and even brought some industrialists to trial in Nuremberg. In the Soviet-occupied zone of Germany, the problem was tackled by expropriation of land and industry on a large scale. The Americans with the Financial Investigation Section of the Finance Division of the Office of Military Government did detailed reports into German banks and industries and their involvement in Nazi and war crimes (OMGUS reports). The Cold War ended those investigations.

During the West German *Wirtschaftswunder* (economic miracle) in the 1950s, once again busi-



*German industry and factories contended with new aspects of business crime after reunification in 1990.*

ness crime and scandal were overshadowed by rapid economic growth. The rearmament of Germany was an opportunity for many bribery affairs connected to nearly every major weapon system and building contract for the armed forces. Minister of Defense Franz Josef Strauss was associated in the public debate with many of these scandals, but actually never charged much less convicted.

Weapon sales, in general, for nearly 50 years were a major source of business crime: In the 1950s the (West) German law had many loopholes in its weaponry export regulations, which were used by dealers for trafficking World War II surplus and more modern equipment. When West Germany engaged in a more controlled export regime, deals outside the North Atlantic Treaty Organization (NATO) hemisphere became legally difficult, especially to war-ravaged regions.

Nevertheless, illegal deals never ceased. German foreign policy came under pressure from its European and U.S. allies, especially after the discovery of production units for chemical weapons supplied by German firms in Rabta (Libya) in the 1980s (called "Auschwitz-in-the-sands" by American media), and for the remains of German-made weapon industry facilities in Iraq discovered after the 1991 war. Because the foreign policy impact became untenable, the control systems against illegal weapon deals were reorganized and better staffed during the 1990s. Nevertheless, on some occasions, the political pressure on the judiciary to play down certain scandals persisted.

### BANKING CRIME

The synonym for business crime in the banking sector in Germany is still the collapse of the Herstatt Bank in 1974. On June 26, the Bundesaufsichtsamt fuer das Kreditwesen (federal agency for the control of the banking system) ordered the closing of a private bank in the Cologne-Bonn region. The bank collapsed after foreign currency speculation failed on a large scale. The indictment for fraudulent bankruptcy against the owner, Iwan D. Herstatt, was not successful but he was convicted of the minor charge of fraudulent currency conversion. The scandal changed the German banking system forever as tougher control systems and larger emergency funds were structured.

German unions nearly collapsed during the Neue Heimat scandal in the early 1980s. The large

union-owned building company was plundered over many years by some of its employees. This affair had an impact on German politics, as the close ties between the unions and the SPD (social-democratic party) helped the CDU/CSU (conservative parties) in general elections of the 1980s. At the same time another scandal, the Flick affair, involved all major German parties. The Flick Company, which already had a legacy of close involvement with the Nazis system, financed for a long period many German parties and politicians. This was called *politische Landschaftspflege* (care for the political landscape). The payments involved violated not only German political party finance laws and taxation rules, but had, in the public view, strong links to actual bribery. When the conservative Helmut Kohl government took office in 1982, it immediately prepared an amnesty law for the crimes committed in this affair, but failed due to a public outcry. Nevertheless, most sentences were very mild. After Kohl left office in 1998, it emerged that he had maintained a system of illegal party funding for the CDU even after the Flick affair.

## ORGANIZED CRIME

Organized crime entered Germany on a larger scale only after the reunification in 1990. Organized crime in former West Germany mainly involved drug dealing and corruption of officials charged with granting building contracts or licenses. The opening to the former Eastern Bloc led to an ongoing new series of trafficking of drugs, stolen cars, and forced prostitutes. On a minor scale, cigarette smuggling was the most visible form of organized crime (with dealers prevalent in Berlin and other big cities), operated by former Vietnamese contract workers of the collapsed East German communist regime. The more important sectors of organized crime were shared and sometimes disputed by German citizens and immigrants from the former Eastern Bloc nations, Turkey, and some African states.

A special form of business crime was created by the division of Germany between 1945-49 and 1990: Western export limitations of high technology products to the East were violated on a large scale; this form of crime was in the public view closely associated with Alexander Schalck-Golodkowski, who was the person within the East German state security organization (Stasi) in charge of illegal transfers. After the reunification in 1990,

large sums of public funds were diverted from the recovery of the East German industry during the process of re-privatization.

The government agency in charge of the formerly East German state-owned industry failed to control the fraudulent use of such funds on a massive scale. This transition period culminated when the building contractor Schneider collapsed in 1994. Into the 21st century, the German judiciary is beginning to cope with business and corporate crime during the "bubble economy," of which is associated with many failed enterprises of the *neue markt* (new economy).

## SEE ALSO

organized crime; corruption; bribery; World War II.

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## Giuliani, Rudolph (1944–)

AS A YOUNG U.S. attorney in Manhattan, New York City, Rudy Giuliani was considered hard-hitting and on his way to greater things. In 1986, Giuliani became the U.S. attorney for the southern district of New York. Giuliani decided that his mission in life was to go after white-collar criminals on Wall Street in a crackdown unlike any the financial center had ever seen. While the insider-trading probe was already in progress when Giuliani came on board, he became its motivating force.

His first target was Michael Milken and his junk bond kingdom, Drexel Burnham Lambert (DBL). Giuliani's first arrest came in May 1986 with the apprehension of DBL investment broker Dennis Levine. Giuliani then went after Ivan Boesky who admitted he had used inside information provided

by Levine and agreed to pay \$100 million in fines. Giuliani and his team convinced Boesky to wear a "wire" to help bring down 10 other traders at DBL who eventually pleaded guilty to securities fraud. It was later reported that Giuliani had allowed Boesky to take a \$50 million tax write-off on his \$100 million fine. Giuliani's 4,152 convictions also encompassed ordinary criminals, including drug dealers, and members of organized-crime families.

Giuliani's treatment of Richard Wighton and Timothy Tabor of Kidder, Peabody, and Company and Robert Freeman of Goldman, Sachs was reportedly very different than those involved in the DBL arrests. People who are accused of white-collar crimes are generally allowed to surrender themselves. However, Giuliani chose to embarrass these individuals by having federal marshals arrest and handcuff them. Wighton, for instance, was arrested at his office, where he was led away in tears. This behavior was also markedly different from Giuliani's arrest of members of the Gambino crime family. Paul Castellano was picked up at home, never handcuffed, and was allowed to buy a candy bar on his way to the police station.

After losing a 1989 campaign for mayor of New York, Giuliani was successful in winning the office in 1993, focusing his campaign on improving the quality of life for citizens of the nation's largest city by improving education and curtailing crime. Some critics argued that the mayor treated a number of groups with no more respect than he showed criminals. Giuliani's record on civil liberties and civil rights was decidedly abysmal. Giuliani supporters, however, pointed to the mayor's record on fighting crime that had resulted in the Federal Bureau of Investigation's (FBI) naming New York City as the safest large city in the country. In addition to safer and cleaner streets, Giuliani reduced welfare rolls and taxes, increased jobs in the private sector, and revived New York City's nightlife.

Ruth Messinger, Rudy Giuliani's Democratic challenger in the 1993 campaign, had pointed out with much truth that Giuliani had no real plan for his second term. He did promise to spend \$64 million more of the city's money to hire 40,000 new police officers. Perhaps the most ludicrous of Giuliani's actions during his second term was his campaign to make New Yorkers more polite. Instead of focusing on hardened criminals, the mayor instructed his police officers to go after jaywalkers, litterbugs, the homeless, "irresponsible" taxi drivers,

"dangerous" bicyclists, food vendors, street artists, and owners of shrieking car alarms. A number of friends and allies turned on Giuliani when he laughed at recommendations from his own 28-member taskforce on Police-Community Relations. When things started to unravel in his second term, his political enemies, including liberals, Harlem politicians, educators, and civil libertarians also turned on Giuliani with a vengeance. The mayor's approval rating dropped an amazing 21 percent.

While Giuliani had survived other crises concerning his overzealous police officers, things came to a head in 1999 when four police officers on routine patrol fired 41 shots at Amadou Diallo, an unarmed immigrant street peddler. When Giuliani called for caution until the facts were known, "Impeach Rudy" and "Depose Rudy" slogans sprouted around the city. The Diallo murder seemed to be part of an overall pattern of harassment and humiliation leveled at minority residents by the police department.

Giuliani's 2000 campaign for the U.S. Senate against First Lady Hillary Rodham Clinton promised to be bitter and expensive. However, in the midst of the campaign, Giuliani announced that he had prostate cancer and withdrew from the race.

By all accounts, Giuliani was a political has-been, and then terrorists, guided and supported by Osama bin Laden's al-Qaeda network, hijacked two planes into the World Trade Center in New York City on September 11, 2001. It was almost as if Giuliani had been born to be the mayor of New York City at this time of crisis. Becoming known as "America's Mayor," Giuliani led devastated New Yorkers and a stunned nation through the devastating terrorist attack. It seemed impossible for him to make a misstep because his concern was so evident and so genuine. He managed to overshadow the still untested president of the United States, George W. Bush.

#### SEE ALSO

Boesky, Ivan; Milken, Michael; Drexel Burnham Lambert; Kidder, Peabody.

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## Global Crossing

GLOBAL CROSSING, Ltd. is an international telecommunications business delivering phone and data services to Europe, Asia, and Latin America. Global Crossing went public in August 1998 at a split-adjusted \$9.50 per share, and barely seven months later, its price had soared to \$64. Its market capitalization, at \$47 billion, briefly exceeded that of General Motors.

Like many of the other high-tech companies of the 1990s, Global Crossing's grand corporate status was brief. It was plagued with unstable management (five chief executive officers in four years) and with accusations of questionable accounting practices. Global Crossing filed for Chapter 11 bankruptcy on January 28, 2002. The company's bankruptcy, at \$26 billion, was the fourth largest in U.S. history ranking just after Enron Corporation at \$63 billion, Texaco at \$36 billion, and Financial Corporation of America at \$34 billion.

Gary Winnick founded Global Crossing Ltd. in 1997. It started by laying fiber-optic cable across the Atlantic Ocean in 1998, and by late 1999 the telecommunications firm had grown to deliver data services to Europe, Asia, and Latin America and was wildly successful. Winnick's secretary became a millionaire, and Winnick paid what is thought to be the highest price ever for a single family home in the U.S., more than \$60 million for an estate in Los Angeles' Bel Air neighborhood. According to Winnick, "Money's no fun unless you spread it around."

In 1997, when Global Crossing was founded, the commercial logic of heavy investments in fibre-optic networks seemed impeccable; there was a global shortage of high capacity cable necessary to meet the data transmission needs of the quickly growing internet. Many high-tech firms attempted to meet this need, and due to competition, bandwidth prices soon plummeted. Like that of many other once high-flying technology and telecommunications companies, the stock of Global Crossing

slid precipitously after March 2000. After reducing its earning forecasts sharply during August 2001, the company announced in October that its revenues and cash flow would fall even further below expectations. The next day, Standard & Poor's removed Global Crossing from the S&P 500 stock index. Winnick's stake in the company shrunk from \$6 billion to \$30 million. In 2003, Winnick was dropped off the *Forbes* magazine list of the 400 richest people.

The Federal Bureau of Investigation (FBI), and the Securities and Exchange Commission (SEC) both opened inquiries into the accounting practices of Global Crossing in February 2002 after Global's former vice president, Roy Olofson, stated that the firm artificially inflated its profits. Global Crossing was sold to Singapore Technologies Telemedia (STT) in October 2003. Although the FBI, the Central Intelligence Agency (CIA), and the Pentagon all objected to the sale due to STT's close relationship with the Singaporean government, President George W. Bush said he had no problems with the sale. The probable sale price was only \$250 million to control 61.5 percent percent of the firm.

### SEE ALSO

accounting fraud; stock fraud; securities fraud; Enron Corporation.

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## global warming

IN THE UNITED States, the early 1970s signaled a new awareness of the effects of continued exploitation of the environment. Over the next 10 years, scientists developed an understanding that global warming was a reality rather than a theory. Despite

the recognition that new environmental policies were crucial, environmentalists were forced to battle with conservative business persons who argued that economic interests should take precedence over environmental protection. However, environmentalists successfully lobbied for the creation of the Environmental Protection Agency (EPA), which was created in 1970 and given oversight over environmental issues. The EPA was also charged with ensuring compliance with new environmental laws and regulations.

In the study of white-collar and corporate crime, environmentalists point to the ultimate criminal industrial act: the aggregate of air and water pollutants and their effects alter the climatic patterns of the earth, endangering millions, if not billions of lives.

While most scientists have recognized the real dangers in the prospect of global warming, a small number of scientists insist that the threat has been overstated. They believe that changes in the earth's temperature are a result of natural cycles. Predictions that the earth's temperature will rise as much as 50 degrees Celsius or 90 degrees Fahrenheit by the middle of the 21st century, however, have created an environment of dire concern. This concern has been heightened by an upswing in worldwide natural disasters that have been attributed to global warming, encompassing everything from extensive flooding and draughts to mass starvation and disastrous hurricanes.

Much of the concern about global warming has been directed toward the so-called greenhouse effect. Actually, the greenhouse effect, which is essential to life on this planet, is created by a naturally occurring blanket of air, or ozone layer, that protects the earth from the sun's extreme heat. However, scientists have distinguished between this natural greenhouse effect and the anthropogenic or unnatural greenhouse effect that is created by the buildup of industrial pollutants that contribute to global warming.

Most scientists agree that global warming is caused by the emissions of fossil fuels that release carbon dioxide and other gases, such as methane, nitrogen oxide, ozone, and chlorofluorocarbons into the atmosphere. The greatest pollutants are coal and oil, but natural gas has also contributed to the effects of global warming. By the end of the 20th century, scientists had also documented an increase in the amount of chlorine in the atmosphere, amount-

ing to more than a 600-percent rise over levels of the previous 40 years. This increase of chlorine in the atmosphere also interferes with the way that ultraviolet radiation is blocked. Deforestation has also contributed to global warming because trees serve as natural barriers to trap pollutants and prevent them from being released into the atmosphere. If the earth's temperature increases beyond a certain point, the flooding of coastal areas could result in the rapid spread of infectious diseases, and the world's food supply might be threatened by extensive draught.

Scientists believe that global warming began in the early days of industrialization when coal and oil were first introduced into the atmosphere, with an accompanying increase in the levels of carbon dioxide. Since World War II, an increase of 25 percent in the concentrations of carbon dioxide and other heat-absorbing molecules in the atmosphere has been documented, resulting in a decreased ability to regulate the earth's temperature. These changes in the earth's atmosphere have a detrimental affect on human beings, wildlife, plant life, and on the overall environment. As worldwide population increases, so does the likelihood of global warming as more pollutants rise into the atmosphere.

## CONGRESSIONAL ACTION

Drastic changes in the behavior that produces global warming should be a priority for legislatures and executives at all levels of government; however, environmental policy often gives way to political and economic concerns. Former Vice President Al Gore is one of the few politicians who has consistently made global warming a priority. Gore's interest in global warming began as an undergraduate at Harvard University under the guidance of Dr. Roger Revelle who was the first scientist in the world to monitor the effects of carbon dioxide on the atmosphere.

For the first time in any presidential election, global warming was a major issue in a presidential campaign when Gore ran as the Democratic nominee in the 2000 election. Gore won the popular vote but lost the presidency to Republican George W. Bush under what many people felt were unfair circumstances. Both as a member of Congress and as vice president, Gore tried to convince other policy makers that the dangers of global warming are real. He worked diligently for changes in environmental

policy that were designed to head off some of the worst effects of global warming.

In 1988, which was seen as a time of particular significance in the study of global warming, Gore was joined by other environmentalists in Congress to push for new legislation aimed at controlling the climatic threat that many people believed had affected an outbreak of heat waves, draught, air pollution, and forest fires. In August of that year, Colorado Senator Timothy Wirth introduced the Natural Energy Policy Act designed to promote energy efficiency and control global warming through limiting deforestation, curbing excessive population growth, and increasing funding for the development of alternative energy sources. Donna Fitzpatrick of the Department of Energy lobbied against the bill, arguing that such actions were premature since global warming was still an unproved theory.

In May 1989, Gore chaired a Senate committee that examined scientific research on global warming. The Gore Committee invited scientists to discuss global warming with the committee, and committee members waded through thousands of pages of testimony. During the examination, Gore discovered that the Bush administration had altered the testimony of James Hanson, a foremost expert on global warming, to make imminent threats of global warming seem less likely. In his testimony, Hanson stated that he was 99 percent certain that global warming was caused by human actions and not by naturally occurring factors. Senators Gore and Wirth lashed out at the Bush administration and demanded that the administration live up to its campaign promises to work toward reducing the greenhouse effect.

Researchers have identified three steps that Congress should take to reduce the effects of global warming on the planet: First, legislative efforts should be made to strengthen fuel-efficiency standards for all vehicles to reduce levels of carbon dioxide emissions. Second, legislators should remove all loopholes in the 1970 Clean Air Act that allow coal-fired utilities to continue to pollute the environment. Finally, Congress should encourage the efforts of coal-powered utilities to convert to natural gas by providing tax incentives.

When the EPA was created, it was given the responsibility of working with the states to help them comply with federal guidelines. Each state then created its own EPA to regulate environmental issues within the state and to work with the federal admin-

istration. Many states began to take an aggressive role in regulating their own environment and challenged neighboring states for spreading pollution outside their borders. For example, in 1997, eight northeastern states petitioned the EPA to force several midwestern states to reduce the emissions of nitrogen oxides that were contributing to urban smog in the Northeast.

In recent years, some states have taken the lead over the federal government to fight global warming. For example, in October 2003, California announced that it would sue the EPA over the decision handed down by the Bush administration that the EPA has no authority to regulate automobile emissions that contribute to the effects of global warming. New York, Massachusetts, and Oregon were also expected to bring suit, along with environmentalist groups such as the Sierra Club and the Natural Resources Defense Council.

## KYOTO PROTOCOL

In 1988 in Toronto, Canada, the World Meteorological Association Organization and the United Nations Environment Program established the Panel on Climate Change to examine the affects of global warming on the nations of the world. As a result of the panel's work, 176 countries participated in a worldwide conference on global warming in 1997 in Kyoto, Japan. The Kyoto Conference produced the Kyoto Protocol in which each participating country agreed to set targets for reductions in the emissions of carbon dioxide and other pollutants that contribute to the greenhouse effect and established a timeline that individual countries must meet.

Industrial nations that bear the most responsibility for environmental pollution were required to initiate changes more quickly than were developing nations that produce less pollution. The Kyoto Protocol also established so-called credits that could be earned by countries with low levels of emission. The credits could then be sold or traded to industrial nations to offset their excessive emissions of polluting gases.

President Bill Clinton signed the Kyoto Protocol on November 12, 1998, pledging that the United States would reduce carbon emissions by 7 percent below the 1990 levels by 2012 and sent the Comprehensive Electricity Competition Act to Congress. In 1999, the Clinton administration an-

nounced new guidelines that would take effect in 2004, mandating cleaner gasoline and requiring oil companies to remove pollutants such as sulphur from gasoline. The new regulations included strict emission standards on all automobiles, sports utility vehicles, and light trucks. American businesses claimed that such actions would necessitate increased energy prices that would in turn reduce consumption. It was estimated that the overall costs of complying with the Kyoto Protocol and Clinton's energy act would be from \$7 to \$12 billion. In May 1999, a United States court of appeals blocked the new EPA standards, agreeing with the business community that the changes would be too costly.

### SIGNS OF GLOBAL WARMING

In the 21st century, global warming is of crucial importance for countries all over the world. A spot near the equator in Brazil, approximately halfway between the North and South Poles, has been used to illustrate the extent of environmental damage caused by civilization. Clouds of smoke hover over the rainforests that are so crucial to the ecological balance of the planet because of the oxygen that they generate. Parts of the rainforests have been burned to make way for factories, fast food restaurants, and other signs of civilization, even though the plants, birds, and animals found in the rainforests can never be replaced. Even the most isolated parts of the world suffer from some of the effects of global warming because of water and air pollution, illegal waste disposal, oil spills, and acid rains that migrate from more civilized areas.

In 2001, scientists reported that the snows of Kilimanjaro (the highest mountain in Africa) which were made famous in 1952 through a short story by Ernest Hemingway, were in danger of melting away by 2016. Glaciers in the Bolivian Alps were expected to suffer a similar fate by 2011. In 2002, scientists reported that a 5.4-degree rise in Alaska's temperature over the previous 10 years had resulted in irreversible changes in Alaska that were causing melting permafrosts, sagging roads, and dying forests. Some people believe that the changes in Alaska's environment can be traced to the 1970s when Alaska was opened up for oil exploration, allowing boreholes to be drilled in the frozen earth.

Scientists announced in September 2003 that a huge ice shelf in the Arctic Ocean, known as the Ward Hunt Ice Shelf, was breaking up after three

thousand years, giving eerie credence to the threat of global warming.

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air pollution; Clinton, William J.; Environmental Protection Agency; Clean Air Act.

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## globalization

ALTHOUGH MODERN capitalism began emerging in the 15th and 16th centuries when international trading became lucrative for Western nations and private enterprise, the new economic world order emerged about 40 years ago.

This new world order is referred to as post-capitalism or globalization. Both terms refer to a set of social, political, economic, and cultural dynamics leading to the development of shared cultures internationally via the internet, the growth of transnational corporations across national boundaries and trade agreements via the European Union (EU), the World Trade Organization (WTO), the General Agreement on Tariff and Trades (GATT) and the North American Free Trade Agreement (NAFTA).

By the mid-1990s these trade agreements increased the U.S. control of the world market from 25 percent to 50 percent. The WTO, created during the 1994 Uruguay Round of the GATT, has members who are not elected but appointed, yet control virtually all trade on the planet. As bureaucratic

trade specialists representing each nation, their only goal is to represent each country's economic interests. With a two-thirds vote the WTO can change existing international trade rules without referring to nationally elected legislatures. Furthermore, member states can challenge other states' laws for being protectionist of domestic industry or discriminatory against imports.

Similarly, NAFTA actually allows transnational corporations themselves to sue nations for violating free trade rights. The absence of an effective and enforceable body of international law leaves this undemocratic system unchecked, and the ensuing economic inequality often transforms into racial, ethnic, and religious-based hatred and sometimes even genocide.

## FINANCING GLOBALIZATION

Free trade or cheap trade is facilitated by a variety of international financial institutions like the World Bank and the International Monetary Fund (IMF). These institutions loan money to developing nations under specific conditions that often dismantle state-run industries and eliminate state-run social, work, and health programs thus harming local citizens while increasing the profits of the transnational companies.

Thus, some economists say historical colonialism and jingoism now exist under the guise of Western loans through the World Bank, IMF structural adjustment programs and multinational corporate exploitation of third world nations through the WTO. Liberalized trade laws and a skewed decision-making structure benefited wealthy nations and transnational corporations while harming less developed and industrial nations. This global structure tolerates repressive regimes, forces population movements, and facilitates genocide, destroys the environment, and violates the human rights of indigenous peoples while damaging health and social welfare programs.

For example, in 1992, the U.S. corporation Occidental Petroleum muscled a deal with the state of Colombia to drill an oil well on the reservation land of the indigenous U'wa people, destroying their land and usurping their power. Similarly in Nigeria, the Ogoni people, an indigenous ethnic minority, have been the victims of a corrupt alliance between the state and Shell Oil Company since 1958, when Shell began exploiting oil and natural gas reserves

leading to oil spills, and air and groundwater pollution. Finally, in Ecuador, ARCO, Shell, and Texaco—preceded by the rubber companies in the early 20th century—have used violence and debt bondage to exploit the labor and land of indigenous tribes. Since 1970, this type of corporate colonization has displaced 18,000 people from 247,000 acres of land in Ecuador.

These treaties exploiting free trade zones have also resulted in corporate complicity with state-sponsored paramilitary or secret police, mistreatment and bullying of workers, and forced movements of indigenous populations to make way for economic enterprise. The Zapatista National Liberation Army, a peasant movement from the Chiapas region in southern Mexico, has grown partly as a result of NAFTA: in lowering trade barriers, NAFTA has also increased the poverty level of peasants and contributed to a loss of Mexican jobs.

Combined, these international trade bodies like the WTO and the European Union translate into minimal government regulation of wealthy transnational companies, limited tariffs across national borders, and increased economic inequality within Western societies, and between Western societies and developing nation states. Specifically, between 1982 and 1990, foreign direct investment between developed and developing nations rose from \$20 billion to \$278 billion, and while this benefits Western elites it generally fails to benefit the majority of the developing nations' people.

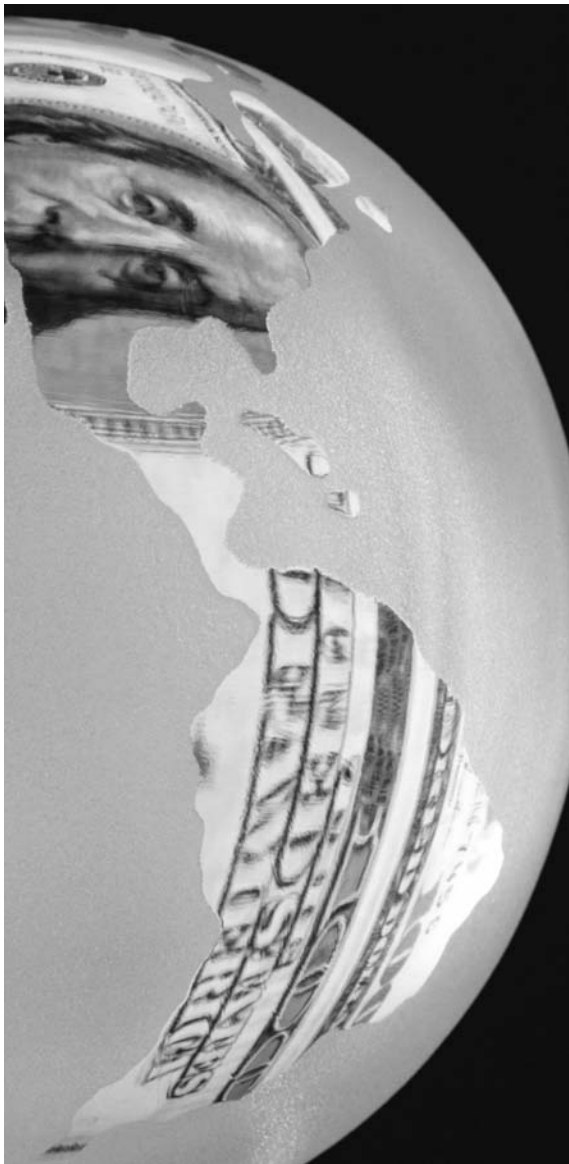
## DE-INDUSTRIALIZATION

The 1974 Trade Act passed during President Richard Nixon's administration and strengthened in 1984, called for a trade policy that sanctioned countries who refused to open their borders to U.S. products. An additional characteristic of globalization includes the growing international immigration trends.

For example, immigrants are now 12 percent of American workers and that often translates into poorer wages fueling growing economic inequality. Moreover, these immigrants move to the United States in search of the American dream denied to them by American industries already transplanted in foreign markets as the result of the free trade agreements.

Additionally, the result of these trade policies for American industry at home includes plant fore-





*The effects of globalization include economic hegemony, the capitalist economic system reigning over native needs.*

closures and primarily loss of jobs to foreign workers overseas. Thus, the de-industrialization of America's inner cities is the result of transnational corporations movement to developing nations. A transnational corporation has roots in one nation and subsidiaries often located all over the world. Many of these corporations have annual profit margins that are larger than the gross domestic product of some nation states.

Most of these transnational corporations were born in the Western world, that is Western Europe, the United States, and Canada and, of course, Japan. Three-fifths of these companies are U.S. companies. In 1970 across the world, only 7,000 transnational corporations existed, by 1996 there were over 40,000 such companies. They control 70 percent of products traded internationally and 80 percent of the world's land under cultivation for export crops. These transnational corporations are also the source of most of the hazardous materials and pollution produced across the globe. This includes the common method of oil extraction and oil refining. Transnationals also control the production of some of the most toxic chemicals known to human kind such as DDT (a pesticide banned in the United States), dioxins and PCBs.

### WORKER EXPLOITATION

This world market also provides cheaper investments with increased profits to corporations as the result of the absence of minimum wage laws in developing nations. These corporations also take advantage of U.S. territories where U.S. labor laws do not apply. Specifically, Saipan, an island in the Commonwealth of the Northern Mariana Islands, maintains a number of U.S. owned garment manufacturing companies that export \$1 billion worth of clothing to America on an annual basis. However, employees working on the factory line are paid about \$2 below the U.S. federally required minimum hourly wage. Ninety-percent of the workers are generally women from China, the Philippines, Bangladesh, and Thailand.

These women are recruited by deception through expensive recruiting fees, trapping the workers in a state of indentured servitude until they pay off their travel fees. The workdays are seven days a week, 12 hours a day with quota production requirements, and the workers are required to live within the plant behind barbed wire fences. This is a global sweatshop.

In 1999 three groups of former workers sued 26 U.S. based retailers, including Nike and the Gap for operating a sweatshop, another group of 50,000 workers filed suit against 18 U.S. retailers alleging a violation of the Alien Tort Claims Act. One suit has been successfully won by the plaintiffs, however, several years later no plaintiff has received monetary reimbursements from any company. Unfortu-

nately, sweatshops like these also exist within the 50 contiguous United States and in other locations across the globe with most operated by large Western transnational corporations.

For example, if you purchase a tee-shirt that indicates it was made in Thailand, Taiwan, or Indonesia, it was probably made by an employee of large U.S. transnational corporation who contracted out its labor for a few cents an hour per employee. While Americans are told this will allow them to buy such clothing at cheaper prices, that is not necessarily the case, rather it is the corporate moguls who are making more money from this arrangement, not the workers and certainly not the consumers. Additionally, these dynamics lead workers in developing nations to believe that they might make more money if they move to the United States. They emigrate only to find that they are trapped in low-level minimum wage service sector jobs, or more dangerous or repetitious manufacturing jobs that American citizens refuse.

Thus, globalization leads to the fragmentation of labor nationally and internationally, making it more difficult for middle- and lower-level workers to organize for better pay and benefits. While simultaneously, those at the top of the economic hierarchy are making more money leading to additional income inequality.

Researchers Arthur S. Alderson and Francois Nielson synthesized these ideas in a cross-national test among 16 different nations and found that direct foreign investment, increased trade from the south to the north (across nations), the percentage working in lower-level service sector jobs (food service, for example), the percentage working in agriculture, and increased immigration, resulted in increased economic inequality among post-industrial nations. Further, declining memberships in trade unions increases economic inequality while increased welfare programming and improved wages across blue- and white-collar occupations resulted in decreases in economic inequality.

The global economic market is also controlled by Western powers using economic sanctions instituted to punish authoritarian regimes and, sometimes, simply to punish nations who disagree on foreign policy issues. For example, in the 15 years of economic sanctions against Iraq before the 2003 war, ordinary citizens were deprived of grain and other necessary goods. These sanctions compounded the Kurdish minority population's inability to

muster the resources necessary to combat Iraqi leader Saddam Hussein's genocidal campaign against them.

Furthermore, Western governments—particularly the United States and the United Kingdom—have installed oppressive rulers, sold weapons to juntas and fostered a “culture of corruption” by allowing transnational firms to bribe foreign officials. Similarly, the U.S. government has controlled insurgent-class or race-based social movements, through its military and the Central Intelligence Agency (CIA), wherever groups threaten U.S. corporate hegemony.

While the Cold War may have been a convenient disguise for CIA-initiated murder and mayhem from Central and South America to Asia and Africa, motives more accurately involve the maintenance of corporate hegemony. For example, the CIA orchestrated the overthrow of democratically elected President Salvador Allende in Chile in the 1970s, a socialist who would ensure state-ownership of businesses, and replaced him with General Augusto Pinochet, a dictator supportive of U.S. capitalist interests. Following the military coup, Pinochet's regime was responsible for over 4,000 disappearances and murders from 1973 to 1975.

#### CORPORATE CRIME = STATE CRIME

Clearly, white collar crime in the form of corporate crime is tied to state crime. Furthermore, these crimes often involve a violation of the international convention on the Declaration of Human Rights, especially on the part of the U.S. based transnational corporations.

For example, in 1992, in the case of U.S. corporation Occidental Petroleum mentioned earlier, the company purchased the right to explore a part of the U'wa's (an indigenous group to the area who have occupied the land for centuries before the government of Colombia began selling it to colonizers) land called the Samaore Block. This land area is a part of the South American rainforest. Occidental petroleum was given the right to drill for oil by the Colombian government in 1999. Specifically, the U'wa tribe was deceived and told they were signing an attendance sheet when they were actually signing an agreement establishing conditions for the exploration of the U'wa land.

Following that white-collar crime, the Colombian government gave permission to Occidental to

continue to explore with any additional meetings with the U'wa. Finally, after years of negotiation with the Colombian government, the U'wa were given official permission to own most of their historically controlled land (543,000 acres).

However, one month later the government gave Occidental petroleum a license to begin drilling oil about 500 meters from the border of the U'wa's land, but still within their ancestral territories. The experts expect that such drilling will result in the typical toxins released from drilled oil wells including arsenic, lead, mercury, benzene, naphthalene and other hydrocarbons that will subsequently lead to large-scale pollution and soil erosion. Occidental has already contaminated surface water in other oil-fields in Colombia at 50 times the rate of acceptable international standards.

The Inter-American Commission on Human Rights has found that human exposure to these chemicals leads to adverse affects including birth defects, cancer, and spontaneous abortion. Such exploitation of the natural environment and harm to humans are becoming widespread throughout the globe, with indigenous peoples bearing the brunt of these harms most directly. And, while some of these harms are considered violations of international law, international law is less respected than the desires of international corporations or their governments and free trade laws.

Though the right to a healthy environment exists in international law through the Covenant on Economic, Social and Cultural Rights (the legal "teeth" of the Declaration of Human Rights), the United States has refused to ratify it. Also, the Rio Declaration is a binding international treaty obliging all nations to recognize the right to a healthy environment, and only 34 out of 190 nations have not signed this agreement.

Economic globalization has deprived the U'wa people (as just one example) of their food supply and clean water, but one of the provisions of the International Covenant on Civil and Political Rights and the Economic Covenant (the second agreement that enforces the Declaration of Human Rights) includes not depriving a people the right to its own means of subsistence. Nonetheless, globalization or free trade allows this situation in Colombia to occur. Similarly, large-scale international dumping of nuclear waste also occurs even though the United Nations (UN) Committee has stated that such offenses violate the human rights to life, health, and

security. But this UN committee has virtually no international enforcement power.

Similarly the Inter-American Commission on Human Rights (a weaker international body than the UN Human Rights Committee) stated that harm from mining activities also violates the right to life and health. The International Labor Organization Convention Number 169 also recognizes the special importance of indigenous peoples' relationship with their land and requires the safeguarding of their environment including protection against the disposal of hazardous or toxic substances. However, many nations, including the United States ignore these decisions and similar international agreements.

## INEVITABLE CONCLUSION

Proponents of globalization profess that what is good for multinational corporations is, in the end, good for the world, just as in the mid-20th century, what was good for General Motors or IBM was good for America. The overt mission of the World Bank and IMF and other such institutions is to relieve world poverty by providing jobs where none existed, to spread the material benefits of capitalism among all people, not just the first world.

But the record of globalization in the issues of environmentalism, labor, and white-collar corruption does not show attainment of lofty corporate worldwide goals. Rather, the modern-day economic globalization and neo-colonization translate into American (mostly) corporate exploitation of the markets of Asia, Latin America, and Eastern Europe, resulting in enormous profits from wanton violation of human rights.

American courts could respond to human rights violations through the Alien Tort Claims Act of 1789. This act permits foreign nationals to sue for violations of the law, including torture, summary execution, genocide, war crimes, disappearance, arbitrary detention, slave trading, and cruel or inhuman and degrading punishment. Some foreign nationals have successfully won lawsuits based upon such human rights violations against nation states and private individuals in the United States. However, in a recent court case by two Burmese employee unions, this act failed to protect Burmese foreign nationals who allegedly lost property, were tortured, and forced to work by Unocal Corporation and a state-owned industry in extracting natural gas.

Ironically enough, the Unocal case had a German Nazi industrial precedent. When Germany surrendered in 1945 ending the European part of World War II, Nazi leaders were put on trial for war crimes in Nuremberg, Germany. One of the Nuremberg trials found four German industrialists guilty of forced labor violations. In 2000, using these Nuremberg cases as a legal precedent, a California District court in *Doe I v. Unocal Corporation*, failed to find Unocal guilty of forced labor practices violating international law, because Unocal took no active steps to cooperate in the forced labor of Burmese citizens, primarily orchestrated by the Burma (Myanmar) state government.

In 2000, the German government signed an agreement to create an industry-funded foundation aimed at contributing 10 billion German marks to compensate the slaves and forced laborers exploited in World War II. This could lead the way to holding corporations responsible for continued human rights abuses under the guise of free trade or economic globalization. The Alien Tort Claims Act does not cover cultural genocide, environmental abuses, violations of freedom of speech or price fixing, as a violation of international law or human rights.

Economic globalization is touted by some media and economists as beneficial. Yet the staggering aggregation of white-collar, corporate, environmental, labor, and human-rights crimes hardly supports the view.

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Africa; Arab nations; South America; Asia; United Kingdom; United States; capitalism; drug trafficking; human trafficking; organized crime; war crimes; labor crimes.

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## government contract fraud

IN ORDER FOR AMERICAN society to function properly, the government must provide its citizens with a variety of services that provide for their safety and security. For example, when a vacant lot full of leaking chemical drums and barrels is discovered in an area that threatens a public drinking water supply, site remediation may be required. Rather than employ a large number of public employees who would be tasked with mitigating a hazard of this magnitude, the government may select a private company to perform the necessary clean up. This private company, commonly referred to as a contractor, works under the authority of a government agency, and the supervision of an agency official.

The agency official responsible for overseeing the contractor's day-to-day activities is known as a contracting officer's representative (COR) or contracting officer's technical representative (COTR). Contractors perform a variety of services for the government, including entering data into information systems, performing scientific experiments, serving as security guards at public warehouses and military installations, constructing buildings and roads, conducting training courses for public employees, and writing and editing government publications. In addition to awarding contracts for services, the government also enters into agreements for products and supplies.

From cleaning solvents and paper clips, to computer systems and military armament, government vendors provide public agencies with a wide range of items that would prove cost-prohibitive for the

agency to manufacture independently. In order to ensure that these products meet the needs of the agency, government officials prepare specifications for these items that must be strictly adhered to by prospective vendors.

Ideally, the U.S. government contracting process, which is budgeted at more than \$200 billion each year, is mutually beneficial to agencies, product manufacturers, equipment suppliers, and service providers. It is intended to encourage competition among prospective contractors who compete for government projects, ensuring that agencies receive quality products and services at fair market prices. Unfortunately, some government contracting agents and prospective vendors conspire to ensure that a specific firm is selected to provide a good or service. Such illicit activities are referred to in the U.S. Code (18 U.S.C. 201) as bribery, which is defined as "... receiving of anything of value in corrupt payment for an official act."

Motivations for engaging in these official forms of corruption may stem from a desire on the part of the agency official to receive a kickback from the selected firm, find employment for a friend or relative (other even for themselves after leaving government service), or receive some other form of gratuity or gift (expensive jewelry, vacations).

Vendors who produce agency-specified goods or provide services to the government may conspire in an effort to artificially inflate the price of a product or service. Firms may also engage in the predatory practice of bid-rigging, meaning that a group of well-established prospective contractors notify one another in advance as to what their proposed cost estimate for a government project will be (the bid submission process is usually confidential), and they subsequently take turns submitting low bids on certain projects. By unfairly exchanging their proposed cost estimates, a few key firms are able to simultaneously set the market price and limit competition by new or smaller companies.

Products manufactured under government specifications occasionally do not meet the standards that have been mandated by the agency. For example, in 2003, the Northrop Grumman Corporation agreed to pay the U.S. Navy \$20 million in penalties after getting caught supplying the military with defective parts for their unmanned drone aircraft.

Lastly, some vendors simply overcharge the government for the total amount of hours rendered

on a project, or deliberately short-change the agency in the quantity of supplies shipped.

In an effort to curtail misusing a government contracting position for personal gain, discourage bid rigging, and reduce the likelihood that defective products will be shipped, the federal government has more than 225 years experience developing and implementing acquisition and procurement regulations.

## A BRIEF HISTORY

As early as 1775, the Second Continental Congress realized that it was essential to the burgeoning nation's growth to "... maximize competition, obtain fair prices, and assure accountability of public officials for public transactions." By 1792, Congress had already passed legislation requiring that military supplies be procured through the Treasury Department and not by the army. This early effort to decentralize the process of obtaining goods and services was followed by statutes in 1861 and 1910, which required the government to advertise solicitations for products and projects. With the exception of times of "public exigency," these regulations remain in effect today for nearly all government agencies.

During World War I, unscrupulous contractors realized that they could make large sums of money by inflating the costs associated with producing military vehicles, weapons, and ammunition and passing these fictitious costs on to the government agencies who purchased these products. Other vendors deliberately conspired to create false shortages of supplies in an effort to drive up prices through increased demand. Some companies aggressively lobbied public officials in an effort to win major contracts to build ships and other projects. In an effort to combat such situations, Congress enacted the Federal Property and Administrative Services Act of 1949, which mandated open advertising for government-procured goods and services. Subsequent legislation designed to promote fair competition and prevent price gouging by manufacturers and suppliers included the Defense Acquisition Regulation and the Federal Property and Administrative Services Act.

In 1974, Congress further streamlined the process of specifying the terms and conditions of contracts through passage of the Federal Procurement Policy Act (Public Law 93-400). The primary

purpose of this legislation was to establish “a single simplified, uniform federal procurement regulation” for all federal agencies. This effort led to the development of the Federal Acquisition Regulation (FAR)—a set of procedures that must be followed by federal agencies when contracting for services or supplies.

### AN INVITATION TO FRAUD?

Despite the post-World War I and World War II efforts of Congress to develop a system that would establish “full and open” competition in federal contracting, subsequent legislation has actually proved contrary to these goals. For example, subpart 19.5 of the Federal Acquisition Regulations (FAR 19.5) requires that certain government projects be allocated to small businesses (that is, companies with less than 100 employees whose total sales do not exceed \$6 million in retail or service industries or \$28.5 million in construction). While small businesses are required to offer their products or services at “fair market value” if a contract is to be awarded, the prospective vendor need not offer the bottom-line lowest price. Thus, the government may spend more money than is really necessary to procure a good or service.

Similar acquisition regulations such as the 1984 Competition in Contracting Act and Federal Acquisition Streamlining Act of 1994 promote the utilization of women and minority-owned businesses for contracting at the federal, state, and local levels. These acquisition guidelines are controversial because some companies simply list such persons among their corporate officers without really utilizing their skills or talents.

For example, in early September 2003, Chicago-area residents James M. Duff and his mother, Patricia Green Duff, were indicted for allegedly “... getting a janitorial service, Windy City Maintenance certified as a women-owned enterprise by using his mother as a front,” as reported by journalist Mike Robinson. The alleged misrepresentation also made it possible for the defendants to receive public contracts “... set aside for such businesses, along with another company, called REM Inc., in which James Duff used a black associate, William E. Stratton, as a front for what was certified as a minority-owned business,” Robinson writes.

Congressional efforts to increase fairness in government contracting and to expand opportuni-

ties for small businesses to compete in the public marketplace continue to have many critics. One of the most common concerns expressed by both Congressional leaders and watchdog organizations is that big businesses and its ties to political leaders continue to overwhelmingly receive government orders for services.

For example, Texas-based Halliburton Corporation, which was previously run by Richard Cheney prior to his tenure as vice president of the United States, received contracts of nearly \$500 million for repairs to oil refinery infrastructure damaged early into the 2003 conflict in Iraq. Cheney received about \$1 million per year from Halliburton as part of his severance package for resigning from the corporation. Similarly, nearly a dozen senior officials of the Ronald Reagan, George H.W. Bush, and George W. Bush administrations have close ties to the Bechtel Corporation, which was selected by the U.S. government to receive more than \$680 million in construction projects in Iraq. In an effort to address such concerns, several lawmakers campaigned to enact legislation designed to limit the use of sole-source bidding on defense and reconstruction contracts in Iraq.

### SEE ALSO

government procurement fraud; corruption; bribery; General Dynamics; kickbacks; Northrop Grumman.

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## government procurement fraud

ONE OF THE MOST IMPORTANT elements in the relationship between public officials and those whom they serve is trust. Private citizens must have

sufficient confidence in government employees to allow them to allocate resources on their behalf. Perhaps the most substantial form of trust bestowed upon civic representatives is the expenditure of public funds. Tax dollars generated from levies on income, real estate transactions, or sales of various goods and services allow our government to obligate these fiscal resources in areas that serve the common good (for example, national defense, public health, education, police and fire protection).

In order to ensure that the supplies and services obtained by the government are obtained at fair market value, and that there is fair competition among interested vendors, there is a stringent legal process, known as acquisition that must be adhered to by public agencies.

Acquisition is defined as “ordering from established sources of supply and services, using small purchase procedures, and contracting” by Management Concepts Incorporated (MCI). The public official responsible for awarding a contract to the vendor who had submitted the most appropriate project bid is referred to as a procurement officer or purchasing agent. Procurement officers and purchasing agents normally work under the direction of a contracting officer. Contracting officers are agency officials “who have been delegated specific authority to enter into and administer contracts on behalf of the government and make related determinations and findings,” according to MCI.

Contracting and procurement officers, purchasing agents, and other acquisition officials hold important positions of public trust in selecting vendors for government projects and ordering agency supplies. Unfortunately, some employees engage in illegal practices for personal gain. For example, in one such case, a regional motor vehicle fleet administrator for the General Services Administration with procurement authority “worked with an automotive repair inspector in a scheme: The vendor, a car-repair company, submitted inflated claims to the GSA officer who approved them, then took cash for the difference between the inflated claim and true cost ... [and they both] took cash sporadically along with free service for their own cars,” explains author Martin L. Gross.

Purchasing agents, contracting officers, and procurement officers are not the only government employees who participate in illegal acquisitions. Senior agency officials may attempt to bypass contracting regulations altogether in exchange for

lavish gifts, luxury travel, or high-paying employment for friends or relatives.

## CASE STUDIES

Former Paterson, New Jersey, Mayor Marty Barnes appeared to have the perfect existence. He was a likable, charismatic politician who had made strides in improving Paterson’s image as an urban city committed to both industry and the welfare of the community. Unfortunately, he also had a desire for the high life—things that could not be obtained on his modest salary as a public servant. Thus, it was not surprising to many local residents that in July 2002, Barnes pleaded guilty to charges of mail fraud, filing false income tax returns, and lying on ethics disclosure statements—a result of his allegedly soliciting lavish gifts from city contractors. Among those items or benefits he supposedly received were vacations to a castle in England with his spouse and to Aruba, Brazil, and the Kentucky Derby with (contractor-supplied) girlfriends, complimentary designer suits, new furniture, various private-sector jobs for friends and associates, and construction of a lavish swimming pool at his home, complete with a Polynesian-style waterfall. In 2003, he was serving a 37-month sentence in a federal correctional facility.

At the same time that Barnes serves out his sentence, former North Bergen, New Jersey, Town Administrator Joseph Auriemma is serving an unrelated three-year prison term for six counts of extortion, corrupt persuasion, witness tampering, and mail fraud. Auriemma allegedly accepted more than \$35,000 in cash and complimentary construction and renovation work (an upgraded bathroom, new roof, new furnace and air conditioning system) on his homes located in Bloomfield and Wildwood, New Jersey, in exchange for awarding nearly \$2.5 million in township and municipal contracts to pre-selected vendors.

Such acts of corruption are by no means restricted to New Jersey or even the East Coast of the United States, as evidenced by a recent massive corruption investigation in San Bernardino County, California. The investigation resulted in multiple federal grand jury indictments against five public officials and two private businessmen for allegedly engaging in a bribery scheme. The scam allegedly involved a complex conspiracy in which the officials would receive kickbacks in exchange for approving contracts to construct billboards at the intersec-

tions of I-10 and I-215 in the city of Colton. Those indicted included the San Bernardino County supervisor and chief administrative officer, members of the city council, and commercial real estate developers.

## COMBATING FRAUD

In addition to aggressively prosecuting those officials who misuse their positions of public trust in exchange for personal gain, the federal government also tracks companies and private individuals who are partners in these illicit acts (that is, bribery, filing false claims for services, or submitting phony invoices for products and supplies). In essence, a procurement official who suspects that a vendor has engaged in an illegal activity can submit a request for debarment to the General Services Administration. Upon review—which includes a form of administrative hearing that allows the vendor to respond to the allegation—the company and/or its principal employees may be entered into a database of parties excluded from participating in federal procurement programs (referred to as the Excluded Parties List System or EPLS).

The specific reason for inclusion in the EPLS (referred to as the cause code) is also entered, as is the duration of the debarment (known as the treatment). Persons or companies included in the EPLS are normally debarred from federal contracts for a minimum of three years up to life. This database is available online to all federal contracting officers, procurement officers, and purchasing agents who use it to screen out disqualified vendors prior to awarding government contracts.

## SEE ALSO

government contract fraud; corruption; bribery; revolving door; kickbacks.

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## Grabosky, Peter (1945–)

PETER GRABOSKY is a professor at the Australian National University, in the Regulatory Institutions Network of the Research School of Social Sciences (in 2004). He holds a Ph.D. and M.A. in political science from Northwestern University, and a B.A. in government from Colby College. Before his current appointment, he served as deputy director of the Australian Institute of Criminology from 1983 to 2001.

Grabosky has held a number of other prestigious positions in the fields of criminology and law. From 1976 to 1978, he was a Russell Sage Fellow in Law and Social Science at Yale Law School, followed by a term as foundation director of the South Australian Office of Crime Statistics from 1978 to 82. From 1981 to 1983, he served as the head of Research and Projects at the Law Foundation of New South Wales. Additionally, Grabosky served as director of research for the Australian National Committee on Violence from 1988 to 1990. His leadership roles include president of the Australian and New Zealand Society of Criminology (1998) as well as deputy secretary general of the International Society of Criminology (1999).

Grabosky has written numerous books and articles on topics such as the use of incentives in the regulatory enforcement of white-collar and corporate crime, prevention and control of cyber crime, information systems, and related criminal justice and public policy issues. Some of his major contributions include *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* (co-authored in 1986 with John Braithwaite); *Crime in the Digital Age: Controlling Telecommunications and Cyberspace Illegalities* (with Russell Smith in 1988); *Electronic Theft: Crimes of Acquisition in the Digital Age* (with Russell Smith and Gillian



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Australia; Braithwaite, John; Fisse, Brent; regulation and reform.

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## graft

ALSO DEFINED AS BRIBES, extortion, influence-peddling, kickback, tribute, or payola, graft is generally understood to be the offer or promise from one party to improperly influence the judgment of a second party. Graft covers a continuum from local police looking the other way for a free meal to a multinational corporation convincing a local politician to allow environmental waste to be stored in his jurisdiction.

The entry of graft into a transaction can come from the person with the controlling influence seeking remuneration, or the person desiring the object controlled by offering remuneration to the controlling party. Within the two extremes, other examples include: goods given to Olympic committee members to favor a certain city, a judge modifying his ruling, a governor issuing a pardon, and a chief financial officer of a corporation allowing stock manipulations to occur.

The problem of graft has plagued the American political scene since shortly after the first European settlements. Governor Benjamin Fletcher of New York (1692–98) accepted graft payments from pirates to allow their criminal activities, as well as demanded payments from local traders for the right to peddle their wares within the city. As more tariffs were later mandated, the success of businesses depended many times on the savings they could achieve between the difference in the tariffs owed, and the graft paid to avoid the tariffs. Boss Tweed and the Tammany Hall political machine of the

1870s brought graft to an art form, effectively controlling all aspects of New York politics; nothing could take place without payments made to the organization. Graft and corruption later marked several presidential administrations: Ulysses S. Grant, Warren Harding, Harry Truman, and Dwight D. Eisenhower.

As it relates to the public sector, graft involves the corruption of the American political system, a system in which elected officials or civil servants are to serve the interests of the citizens and not themselves. Graft, as it involves public corruption, violates an official's understood duty of faith. Graft can happen at the national level, for example, Absecon of 1970s and Wedtech of the 1980s; at the state level, for example, Florida judge Alcee Hastings' impeachment trial of 1989; or the city/county level, for example, Jefferson Parish (Louisiana) judge Ronald Bodenheimer's guilty plea in 2003 to fixing a civil domestic case. Often the offenders are persons wanting to gain an upper hand in a business transaction.

Some have come to believe that the grease of graft is required to navigate the political landscape; but the result of the "grease" is increased cost in most instances. As graft and bribes are not generally regarded as legitimate business expenses, the cost of the graft is then hidden elsewhere.

Graft paid to building inspectors has led to injuries caused by structural failures, and graft paid to judges has allowed criminals to remain free and possibly commit additional crimes. Graft paid to private sector recipients may result in medicines being approved through testing falsification, service contracts being awarded to a less qualified vendor, and entrance of a criminal element into financial operations.

#### FIVE AREAS OF GRAFT

Graft can be delineated into five areas: contractual, judicial, law enforcement, legislative, and regulatory. Contractual graft concerns the awarding of contracts in instances where the award of the contract is influenced by the payment of graft. The majority of these contracts emanate from the public sectors: road contracts, sewerage work, services, and equipment. Private sector contracts are often impacted by the payment of graft. The amount of graft offered in some contracts has eclipsed into hundreds of thousands of dollars.

Judicial graft concerns situations in which judicial decisions are influenced because of compensation, or promise of compensation, made to members of the judiciary. The decisions include: the outcome of civil and criminal trials, sentencing, the acceptance or rejection of charges, ruling during trials (admission of evidence, acceptance/refusal of testimony, applicable standards, etc.), and the assignment of a case to a particular judge. Graft can impact the decisions of not only judges but also other court officers, including prosecutors, records and docket clerks, and administrative personnel.

Law enforcement graft concerns instances in which policing decisions are implemented based on the receipt of bribes. These decisions range from misuse of police discretionary powers to intentional commission of felonious acts. Graft can impact a beat officer's decision to not arrest a neighborhood bar owner for selling alcoholic beverages to underage minors in exchange for free drinks, or incite a narcotics officer to execute a witness against an illegal drug operation in exchange for a cash payment.

Other policing acts influenced by graft include: failure to enforce criminal laws, charging for services which are part of their duties, supplying a police presence for convenience of criminals, destroying evidence, purposely violating an offender's right to obtain a later dismissal of the charges, theft of seized evidence (drugs) to return to the criminal owners, sale of confidential police records, and disclosure on information concerning pending enforcement actions, including raids, undercover investigations, wiretaps, and surveillances.

Legislative graft concerns situations in which legislative decisions are swayed by improper offers of personal gain. Impacted legislative decisions can include: passage of bills concerning zoning, passage of licensing or blockade of licensing bills, passage of bills concerning land or building grants, and passage of bills concerning settlements of lawsuits against the legislative body. The classification of persons involve can be Congressmen, legislators, Senators, commissioners, city council members, school board members, alderman, governors, and mayors.

Regulatory graft concerns the actions of regulatory board members who award or refuse licenses, certificates, and permits based upon graft payments. Regulatory boards action in question include the issuance/denial of: building permits, variances in zoning, taxi permits, operator licenses, retail alcohol



*From earliest civilizations, graft has always balanced the scales of justice in everyday life.*

outlet permits, health inspections, and professional licenses. The acceptance of graft can cause non-qualified persons to obtain professional permits and licenses; as well as businesses to open contrary to the wishes of the local population.

#### SEE ALSO

bribery; police corruption; kickbacks; organized crime; consequences of white-collar crime; Grant, Ulysses S.

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## Grant, Ulysses S. (1822–1885)

THE 18th president of the United States and the commander of Union forces during the Civil War, Ulysses S. Grant was associated with one of the most scandal-ridden presidencies in the history of the United States. While the concept of white-collar crime did not fully develop until the following century, federal officials were involved in some of the same sorts of investigations that have haunted contemporary administrations, including the criminal activities of a number of individuals within the president's administration. Grant was a popular choice for president to succeed Andrew Johnson (1808-75) who had become president after the assassination of Abraham Lincoln (1809-65).

The Grant presidency was a time of great political turmoil, and it was highly unlikely that any president of the time could have pleased the South recovering from the devastation of the Civil War while meeting the demands of the civil rights advocates who were anxious to establish political rights for former slaves. Grant was forced to walk a political tightrope as he oversaw the process of reintroducing the former Confederate states into the Union. Despite all the scandals of his presidency, Grant remained a hero to many Americans outside the South. While some contemporary scholars have argued that Grant was not directly involved in many of the scandals attributed to him, they did occur on his watch.

Grant lacked political experience and was not a loyal Republican. He had only voted for president once in his life when he cast a vote for Democrat James Buchanan in 1857. White House insiders had a low opinion of Grant as an administrator. It was well known that he often failed to appear at scheduled meetings, and Grant was notorious for neglecting to read important documents and for forgetting to answer urgent letters. He was ill equipped to deal with abuses of power by his staff or cabinet members. Grant was forced to deal with a Congress that had wrested as much political power as possible from his predecessor, including an impeachment that fell one vote short of removing Andrew Johnson from office. Congress saw no reason to yield power to Grant.

With Reconstruction at its height, partisan sniping was at an all-time high. From the beginning, Democrats claimed that the new president was a

thief, citing evidence of looting during the Civil War. The press frequently presented Grant to the public as a drunk who was incapable of exercising political judgment. Even the leadership of his own party was furious with him because he had chosen family members, army buddies, old friends, and campaign contributors to fill important political positions without consulting Republican politicians.

The Grant presidency was also known for its nepotism. Grant's father, brothers, brothers-in-law, father-in-law, and various relations of Mrs. Grant were all in positions to profit from association with the president. Grant's cousin, Silas A. Hudson, was named as a minister to Guatemala; his brother-in-law, Reverend M.J. Cramer was appointed as counsel to Leipzig. His wife's brother-in-law, James F. Casey, was given the position of collector of customs in New Orleans, Louisiana, where he amassed a fortune by stealing customs fees. Fred Dent, the president's brother-in-law and a White House usher, pedaled information that he garnered from listening in on secret meetings. Overall, around 40 of the president's relatives or family connections profited in some way from Grant's presidency.

The Civil War had provided fertile ground for profiteering, graft, and other forms of corruption, and money makers saw no reason to call a halt to their various making-making schemes in the years following the war. While a stronger president might have instituted reform, Grant was incapable of doing so. One of the first scandals to surface involved Secretary of State John Rawlins. After Rawlins died during his first year in office, it was discovered that he had received \$28,000 in bonds for his attempt to garner American support for Cuba in its fight with Spain.

A more serious scandal concerned William W. Belknap, the secretary of war, who reportedly made \$100,000 a year by selling licenses to dishonest suppliers. George M. Robeson, the secretary of the navy, earned \$320,000 in payments from navy vendors anxious to win government contracts. Columbus Delaware, the secretary of the interior, accepted bribes to record fraudulent land grants. William A. Richardson, the secretary of the treasury connived with the notorious Ben Butler to make money from delinquent tax payments. George H. Willen, the attorney general of the United States, used government funds to equip himself with a high-priced carriage and servants. The U.S. minister to Brazil, James Watson Webb, managed to extort \$100,000

from the Brazilian government for his personal use. Robert C. Schenck, the minister to Great Britain, sold nonexistent shares in a silver mine in Utah and claimed diplomatic immunity from prosecution.

Abel R. Corbin, a shady Wall Street operator and brother-in-law of Grant's, was employed by speculators Jay Gould and Jim Fisk in a scheme to make millions by cornering the gold market. For a \$25,000 payment, Corbin convinced Grant that farm exports would benefit from higher gold prices. The Treasury Department was subsequently told to refrain from selling gold as a means of stabilizing its price. The Gould/Fisk deal drove the price of gold from \$135 an ounce to \$163.50 an ounce, threatening economic stability on what became known as Black Friday.

Grant responded by ordering the sale of \$4 million in gold reserves, and the price of gold dropped to \$133 an ounce within 15 minutes of the sale. Another Grant scandal involved a scheme for the United States to take over the Caribbean island of Santo Domingo with the full assistance of the island's corrupt president who anticipated huge profits from the deal.

The Credit Mobilier scandal, which helped to define the Grant presidency as corrupt, actually took place between 1867 and 1868 while Andrew Johnson was in office. It was not until 1872 that the facts became known. The scandal occurred from the manipulations of the promoters of the Union Railroad who created a construction company to skim huge profits from federal subsidies, and sold shares that paid dividends of up to 350 percent to several corrupt members of Congress, including the speaker of the House and future president James A. Garfield (1831-81) who was assassinated only months after taking office. Other participants included Vice President Schuyler Colford and Congressman Oakes Ames of Massachusetts. In the eyes of the public, the scandal seemed to represent the worst of "Grantism."

Another major scandal erupted with revelations about the Whiskey Ring, an entire network of whiskey distillers, headquartered in St. Louis, Missouri, who had defrauded the government of \$1.2 million by avoiding taxes on their products with the help of a number of government officials. Ultimately, 152 distillers and 86 government officials were indicted, including Grant's private secretary Orville E. Babcock. Through Grant's influence, Babcock was exonerated while most defendants were

found guilty. While the scandal had begun during Johnson's tenure, Grant was implicated because he had accepted a team of horses and an expensive harness from members of the Whiskey Ring.

Corruption touched Grant even more directly after leaving office. The former president invested his entire life savings in a Wall Street partnership with a crooked associate. In 1884, Grant's assets were only \$210 and his home, and he was forced to declare bankruptcy. Mark Twain (author Samuel Clemens) published Grant's memoirs, with the intention of giving Grant 75 percent of the profit to help him recoup financially. By this time the former president had throat cancer, and he died on July 23, 1885.

#### SEE ALSO

graft; corruption; bribery; kickbacks.

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## Grassy Narrows

THE SEVERAL hundred Ojibwa people in the community of Grassy Narrows in Ontario, Canada, became the victims of mercury poisoning from a nearby paper mill. Despite the known hazards of mercury, neither the provincial government nor the mill made any effort to protect the Native Americans until significant irreparable damage to the economy and the people had occurred.

The dangers of mercury have been suspected for centuries. Workers who used mercury, such as those who made hats, often appeared to go mad. This chemical element, found in nature, causes violent tremors, manic-depressive behavior, and temperamental instability. The manufacturing plants that served the pulp and paper industry were the biggest users of mercury prior to 1970. The chemical played an integral role in the electrolytic produc-

tion of caustic soda and chlorine (paper dyes). The plants released great amounts of mercury both in wastewater and exhaust gases.

Mercury in water is far more dangerous than mercury in the air. In bodies of water, a phenomenon takes place whereby inorganic (or metallic) mercury settles into the sediment and is transformed into the much more toxic form, or organic (or methyl) mercury, by a process known as biomethylation. Microorganisms living in the sediment protect themselves by converting inorganic mercury into methyl mercury, which is considerably less toxic to them. Methyl mercury then moves up the food chain as larger organisms consume small organisms. Once inorganic mercury has been added to a water system, it takes decades or more to clear.

## MERCURY POISONING

When a person consumes a fish that is full of methyl mercury, the chemical is carried by the blood through body tissues. It concentrates in the heart, intestine, liver, and kidneys. Most of the clinical symptoms of mercury poisoning are related to brain and nerve lesions. Mercury destroys cells in the cerebellum, which regulates balance, and the cortex, which influences vision, as well as the frontal lobe, where it may cause disturbances in personality.

Swedish scientists established that abnormally high levels of mercury found in fish and wildlife were related to upstream pulp and paper plants. In 1966, the World Health Organization informed the Canadian Department of Health and Welfare that mercury could be a serious health hazard. In 1969, a University of Western Ontario study confirmed that fish taken downriver carried body burdens of mercury that were sometimes more than 40 times the standard set for export and human consumption. Federal officials did nothing. Finally, in 1970, the Ontario Minister of Energy and Resource Management ordered all companies in the province with substantial industrial mercury losses to stop discharging mercury into the environment. In that same year, Ontario banned commercial fishing on all lakes and tributaries of the English-Wabigoon river system.

One of these companies affected by the discharge ban was Dryden Chemicals Limited, a subsidiary of Reed Paper Limited. Between March 1962 and October 1975, Dryden operated a mercur-

ry cathode chlor-alkali chemical plant that produced chlorine and other chemicals for bleach in the adjacent pulp and paper mill of Reed Paper. During that period, scientists estimated that about 40,000 pounds of inorganic mercury entered the environment with about half of the amount going into the river system. In 1970, treatment systems were installed to isolate the heavy metal in the effluent. Although this resulted in a significant decline in the amount of mercury discharged, aerial emissions continued unabated. The release of mercury finally ended in 1975 when Dryden changed its technology.

Throughout the 1970s, Dryden executives denied any culpability for the mercury contamination of the English-Wabigoon. They initially insisted that mercury occurs naturally in the environment of the Canadian Shield and then shifted to a defense of ignorance of the process of biomethylation. Dryden's strongest line of defense was marshaled around the idea that the company had a sort of license to pollute from the Ontario government because it had followed Ontario environmental regulations and standards. The Ontario government attempted in the early 1970s to make compensatory payments to 19 Grassy Narrows fishermen. These "forgivable loans" averaged only \$311.08 per person with the total compensation paid to the community amounting to only \$5,910.

The impact of the mercury upon Grassy Narrows has been significant. Many of the Ojibwa made their living through commercial fishing or as fishing guides for tourists. Both the fishing industry and the tourism industry in the English-Wabigoon watershed collapsed. Fish also served as an important source of protein in the diet of the Ojibwas, especially for families too poor to purchase meat. Besides the collapse of a way of life, the mercury damaged the bodies of the Ojibwa and took away their hope of a future. Violent outbursts have become common among the Indians as have clumsiness, depression, and apathy. The Ojibwa now have such significant mental health problems that Grassy Narrows has become a place where suicide and violent death are the norm.

## SEE ALSO

water pollution; Environmental Protection Agency.

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## Great Electrical Equipment Conspiracy

IN SEPTEMBER 1959, the U.S. Senate began committee hearings into allegations that the largest electrical-equipment makers in the United States were conspiring to fix prices. Among the manufacturers were major providers General Electric, Westinghouse, Allis Chalmers, Federal Pacific Electric, and smaller companies including ITE Circuit Breakers, AB Chance, Southern States Electric, and Cutler Hammer.

Since the 1940s, General Electric had feared competition—and had already accrued a long list of violations. In 1950, the company began to work to minimize competition and preserve its share of the market, and the other companies cooperated with the industry leader. General Electric dominated the heavy electrical equipment markets, with a market share of 40 to 45 percent. Westinghouse was next with 30 to 35 percent, and Allis-Chalmers and Federal Pacific each had 10 percent. During the 1950s, sales of heavy equipment brought these four companies an average \$1.75 billion a year.

That was too much of a temptation for executives under pressure to maximize profits and hold market share. Thus, leaders of the companies colluded to fix prices on turbines, switchgear, and other heavy equipment that they sold to the various governments.

Although the practice went on for years, the investigation began only when the Tennessee Valley Authority (TVA) noticed that it had been receiving identical bids from 47 manufacturers for three years. The bids were supposed to be secret, but the dollars were identical. Other government agencies—at the state, local, federal levels—had the same experience, but TVA was the first to disclose it. The TVA had a huge stake in the outcome because it had the largest electrical generating capacity in the United States and was a massive purchaser of

electrical power equipment. Tennessee was also home to Senator Estes Kefauver, chair of the Senate Subcommittee on Antitrust Activities.

The investigation revealed that the companies had worked together for some time to divide the market in line with the market shares each company had at the onset. Executives met secretly to discuss bids, leading all companies to tender exactly the same dollar bid. For instance, when the TVA asked for bids on 4,200 insulators, it received eight bids—all for exactly \$12,936.

The process was simple: Chiefs of various divisions of the companies would meet at public locations, such as sporting events or country clubs, and would establish the amount of the winning bid, the mid-range bid that most would offer, and a low bid for each solicitation under the government sealed bid process. To avoid charges of price fixing, the officials would not assign winning bidders. That would be determined under a pre-arranged schedule, with the winner rotating on the phases of the moon.

The bids could be significant. In one case, the colluded bid was \$198,438.24, and the winner undercut seven identical bids. Over time, each company maintained its market share. The strategy worked for decades until the coincidence in prices brought on an investigation. It is estimated that the conspiracy cost taxpayers \$175 million for each year of its existence.

Federal indictments came down in June 1960. More than 50 executives pleaded guilty or no contest and received large fines. Most individuals received prison sentences, later suspended. Many, naturally, lost their jobs. Seven vice presidents and division general managers at General Electric, Westinghouse, and two smaller companies served 60-day prison sentences. GE received a fine of \$437,500, and two executives went to jail for 30 days after paying fines of \$16,500.

The case was significant as the first to send corporate leaders to prison for violating the price-fixing ban of the Sherman Antitrust Act of 1890, 70 years after its enactment.

Even after the Great Electrical Equipment Conspiracy, companies were disinclined to compete. General Electric took a more subtle approach to avoiding price competition: It advertised its prices, fixed and non-negotiable, and promised to sell at no lower prices, not undercutting competitors. It also promised to refund differences if its prices became

lower. Westinghouse tested the GE pricing strategy by lowering its prices; when GE gave rebates to match the Westinghouse prices, the industry knew that prices would be stable. Competitors adjusted their prices to match GE, and for more than a decade after that prices remained stable, as did profit margins and market shares.

#### SEE ALSO

illegal competition; price fixing; price discrimination; General Electric.

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## Greece

WHITE-COLLAR and organized criminal activities are well established throughout Greece. Tax evasion, embezzlement of company funds, and the sale of fictitious insurance plans are examples of financial crimes conducted by white-collar criminals in the ancient nation. White-collar criminals also generate illicit funds through check, credit card, insurance and securities fraud, and embezzlement. The illicit profits garnered by white-collar criminals are routinely transferred through a variety of banking and non-banking institutions

For example, casinos, once nationalized, are now privatized, and create a potential vulnerability for money laundering. Additionally, Greek government bonds are held anonymously, purchased in cash, and ownership reporting is not required, so long as the value of the bonds remains under an approximately \$15,000 threshold. Domestic media reports routinely link Greek organized criminal gangs to a variety of illicit activities, including drug traf-

ficking, prostitution, arms smuggling, blackmail and gambling activities. The lack of a strong anti-money laundering regime also attracts foreign-based organized criminal gangs to Greece. Since the mid-1990s, a host of foreign criminal groups, including Albanian, Italian and Russian gangs entered Greece to establish a base for criminal activities.

Greece is not a major global money laundering center, but the country has considerable regional importance, due to its geographic position in relationship to the Middle East, the Balkans, and membership in the European Union. The civil strife in the Balkans, major drug trafficking and illicit smuggling through Albania and Kosovo, a range of criminal activities in Bulgaria, and drug trafficking out of Turkey provide opportunities for Greece to be a regional center for narcotics trafficking. Domestic and foreign gangs generate annual profits of \$11.5 billion within the country. Organized criminal groups allegedly launder illicit funds through the Greek stock market, casinos, and, in some cases, banks.

The Greek stock exchange is allegedly a vehicle for laundering illicit proceeds raised by domestic and foreign-based criminal gangs. For instance, in March 2000, local Greek criminal gangs reportedly engaged in extensive money laundering of funds raised through extortion schemes through the Athens stock exchange and Athenian banks. The transfer of illicit profits is also facilitated by the nexus between individual Greek businessmen, and organized criminal gangs.

For instance, a hotel complex on the island of Kos allegedly generated nearly \$800,000 through a narcotics smuggling partnership between Greek citizens and Colombian traffickers. Illicit profits were laundered through the Greek stock exchange and banking institutions in Greece and Switzerland. Media reports also allegedly link organized criminal gangs to the Greek shipping industry. From 1999–2003, there were public accounts in Greece of ongoing investigations by Greece's drug squad of large, multi-ton cocaine smuggling operations involving Greek ships.

The immense funds generated by domestic and foreign-based criminal networks results in bribes that corrupt political and law enforcement officials. International narcotics traffickers have reportedly infiltrated Greek law enforcement agencies. For example, a recent scandal resulted in the prosecution of seven anti-narcotics unit members of Greece's

National Police Force for aiding Colombian narcotics traffickers.

The growth of domestic gangs and the influx of foreign-based criminal groups throughout the late 1980s and early 1990s are directly linked to the lack of a stringent anti-money-laundering policy regime in Greece. The increase in criminal activity in Greece attracted the attention of the European Union (EU). To maintain the status of an EU member state, Greece was required to increase efforts against domestic and international criminal gangs.

In response to pressure from the EU, Greece adopted anti-money-laundering legislation in 1993. The law, however, was deemed inadequate by the EU. In 1995, Greece amended the legislation to meet international standards. Most importantly, the 1995 law obligated all Greek financial institutions to comply with provisions to combat money laundering, including broker dealers, credit institutions, mutual fund managers, and members of the Athens Stock Exchange, foreign exchange houses, insurance companies, and branches of financial institutions, which have their main offices overseas.

The punishment for each money-laundering offense is imprisonment for up to ten years. A lesser offense of concealing money laundering, which would apply, for example, to an officer of a bank who knowingly conceals information pertaining to laundered funds, is punishable by a minimum prison sentence of two years, extending to up to 10 years if it amounts to aiding and abetting or receiving laundered funds.

Increased legislative, regulatory and enforcement efforts resulted in a significant reduction of financial institutions linked to illicit finance schemes. The Greek public prosecutor stated in February 2001 that money laundering was migrating from the Athens Stock Exchange to the real estate market in Greece, stating that the enforcement efforts aimed at the exchange was causing the illicit profits to seek a less regulated sector. Increased enforcement efforts also limited the transfer of illicit proceeds through the Greek banking sector.

To avoid detection, organized criminal groups increased the trafficking of illicit proceeds through couriers to neighboring states. As a result, the funneling of illicit assets through alternative financial mechanisms indicates that recent measures by the Greek authorities are limiting the financial streams available to white-collar and organized criminal groups.

#### SEE ALSO

Italy; organized crime; drug trafficking; human trafficking; prostitution; money laundering; bank fraud.

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TRIFIN ROULE

JOURNAL OF MONEY LAUNDERING CONTROL

## Green, Mark J. (1945–)

MARK GREEN HAS served as New York City's consumer affairs commissioner and public advocate. He is the author or editor of numerous books on government, business, and consumer issues, including *Who Runs Congress?* (1972), *Corporate Power in America* (1973), *Winning Back America* (1982), and *The Consumer Bible* (1995). His most recent book, *Selling Out* (2002), focuses on how corporate money corrupts elections in America.

Green has spent most of his career exposing the crimes and misdeeds of large businesses. After graduating from Harvard Law School, Green worked with Ralph Nader from 1970 to 1980 as a public interest lawyer, ultimately becoming head of the Public Citizen's Congress Watch. From 1990 to 1993, he served as Consumer Affairs Commissioner, leading a \$17-million agency that handled 23,000 consumer complaints annually.

Agency initiatives included investigating how minority consumers were forced to pay more for groceries, auto insurance, and home improvement contracts; laundries and hair salons engaged in gender-price discrimination by charging women more than men; and tobacco companies targeted children in their marketing efforts. Green also helped garner support for a new law that banned cigarette vending machines.

Green was elected as the first New York City public advocate in 1994 and served for two terms. He was an early critic of the New York Police Department's (NYPD) failure to discipline abusive cops, and he won a lawsuit against the NYPD for



blocking access to internal files on the disciplinary process. Green co-authored New York City's landmark campaign finance reform law. He was also active in curbing healthcare abuses, hospital non-compliance with limits on resident working hours, and nursing-home health violations. His initiative to improve the child welfare system was a semi-finalist in the Innovations of American Government awards.

## MAKE DONATIONS

Discussing the problems that arise when local corporations dominate community affairs, Green has asserted that "specific government compulsions" are needed "to stop industrial pollution, to assure racial freedom, to encourage local investment, and to reduce corporate economic and political power." To remedy the abuse of corporate power, he has suggested that corporations should make donations to community boards, which could then decide where to best allocate the money.

Green has argued that American democracy is threatened by the way that corporate money dominates the political culture. He described how stock values plummeted in 2002 "due to lost investor and consumer confidence because of how Congress had been shut-eyed sentries for years when it came to corporate crime." He insisted that the integrity of the nation's political system must be restored before citizens would be willing to invest deeply in the financial system.

Green was the 2001 Democratic nominee for the office of mayor of New York City, but he lost to opponent Michael Bloomberg. In 2003, he was a visiting lecturer at the New York University Law School and president of the New Democracy Project, an urban affairs institute.

## SEE ALSO

prosecution; Nader, Ralph; police corruption; campaign finance; corporate liability.

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## greenmail

GREENMAIL IS the practice of buying back raiders' shares at a higher market price in order to block a hostile takeover. R. Edward Freeman and colleagues (1987) distinguished between the threat condition for greenmail and the compliance condition. The threat condition to the holding company consists of the greenmailer threatening to engage in a hostile takeover of a company unless the management buys back the greenmailer's stock at a premium.

The compliance condition is simply that the management is forced to buy back or repurchase greenmailer's stock holdings at a costly premium. This distinction allows us to consider the morality of greenmail under two basic heads: The criminality of the threat of greenmail, and the morality of exacting compliance.

Managers' behavior is most often dictated by career concerns. They value their esteemed positions because of the goods they can enjoy in their managerial position. Hostile takeovers are not usually favorable to the interest of labor as stakeholder, and hence it may be of considerable importance that labor have some say when defense mechanisms or greenmail payments are considered. Paying greenmail enables management to guard their interest while further providing job security, whereas other stakeholders are vulnerable to takeovers and have little means of being empowered during such attempts. Therefore, there may be particular cases where an exorbitant amount is paid out to save management jobs, and the cost of making greenmail payments is absorbed by employees being given lower wages than otherwise expected.

Greenmail is one of the mechanisms used by top management teams to defend their companies against hostile takeovers. This term refers to a type of transaction in which corporations' repurchase a block of stock from a dissident stockholder declaring himself a takeover contender to top management's control position. Hostile acquisitions of a corporation amounts to a short-term tactic for immediate financial gains for the contending force. In general, making greenmail payments to the aggressing force generally causes a drop in the stock price of the repurchasing firm.

The commonly accepted theory is that paying greenmail exemplifies entrenched management protocol and harms shareholders (an example of

agency theory). Stockholders' rights activists concerned with the adoption of corporate governance best practices have been vigorously opposed to greenmailing asserting that the process deprives the shareholders any potential of economic benefits created by a "clean" takeover.

A contradictory theory in the debate suggests the opposite effect to greenmailing outcomes. The assertion is that greenmail payments benefit shareholders by providing flexibility to management. If this theory is true, the absolute prohibition of greenmail would reduce the value of a company's stock entirely. In pursuit of a company acquisition, the action does not go un-noticed by investors, who view the takeover attempt action to designate the company shares as decreasing in value, and the undervaluing of shares creates a chain reaction leading to sharp and sudden value in the company being acquired. The resulting undervalued shares are quickly acquired by the dissident stockholder at less than fair market value. However, what stock (at the newer undervalued price) is available to the takeover entity is not also available to the other shareholders. Thus, the other shareholders, once locked out from repurchasing undervalued shares, will instead see the takeover entities receiving a significant premium above the current market price.

Greenmail can actually benefit shareholders. It can solve otherwise insuperable transaction cost problems shareholders would face in fending off an unwanted or unduly low takeover bids. By doing so, it also facilitates the initiation of an auction for the firm's shares, a particular benefit in firms whose primary products are infrequently traded, making their value more difficult for shareholders to ascertain.

For example, the targeted repurchase of Saul Steinberg's shares by Walt Disney Productions in 1984 illustrates how greenmail can work to shareholders' benefit. In this case, even as greenmail was paid, incumbent management was given to understand that this could have no entrenching effect. Greenmail was needed to induce the first bidder to depart, before other takeover bidders quickly appeared. The time gained by the greenmail allowed the board time to restructure firm management.

Some states had adopted some type of statutory takeover controls as of mid-1992. One of the most popular forms of takeover regulation techniques is the anti-greenmail laws. These statutes block the discriminatory repurchase of a specified

percentage of a company's shares at a premium-to-market price from an investor who has held shares for less than a statutory minimum amount of time. These laws do not restrict repurchases where the transaction is approved by shareholders or the same offer is made to all shareholders. States with laws restricting the payment of greenmail include: Arizona, Nevada, Tennessee, Michigan, New York, Wisconsin, and Minnesota. An effective corporate board of directors would be expected to disapprove of a greenmail transaction that only served top management's interest in securing its control position.

#### SEE ALSO

stock fraud; securities fraud; ethics; board of directors.

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## Greenpeace

GREENPEACE IS A non-governmental organization (NGO) that was established in 1971 to campaign for sustainable development and good environmental management, and against practices considered to be inimical to its goals. The original stimulus to create the group was to protest against the underground testing of nuclear devices by the U.S. government at the island of Amchitka off the coast of Alaska.

The method of protesting was to provide witnesses to activities that would otherwise have remained secret, alerting media, and attracting cover-

age. In some cases, passive physical resistance has been used, for example by placing small unarmed boats in the way of vessels believed to be carrying nuclear fuels. The activities and causes championed by Greenpeace have been so popular that it has become a worldwide organization, with a presence in 41 countries and nearly three million members. This has brought the group and its members into conflict with both governments and the private sector. Perhaps the most notorious incident occurred when the Greenpeace vessel *Rainbow Warrior*, which had been actively monitoring the activities of French troops and officials involved with testing of nuclear devices in the South Pacific, was boarded and sunk by French special forces, with loss of life.

In recent years, the deregulation of much business activity in many countries of the world, in combination with the forces of globalization that have made truly integrated international activities much more possible, has greatly broadened the scope Greenpeace activities. These include protesting international transportation of nuclear and other types of waste, the introduction of genetically modified organisms, and attempts to develop new weapons systems.

More longstanding campaigns confront whaling and pirate fishing, environmental degradation, and mismanagement, and examination of potentially hazardous chemical processes. Successful campaigns have resulted in the Basel Convention banning the export of hazardous wastes from countries, the establishment of an Antarctic whale sanctuary and an European Union (EU) decision to phase out driftnets.

The relaxation of regulations and the use of heightened security tensions by the United States and other governments restricting civil liberties have opened a number of new threats to Greenpeace's agenda. In 1999, for example, Greenpeace bank accounts were frozen in the United Kingdom (UK) and its vessels ordered to leave UK waters in response to the activities of the Greenpeace ship, the *MV Sirius* that had blocked the departure of two ships transporting nuclear matter to Japan. In August 2001, 17 people, including 15 Greenpeace activists, were charged with felony offenses for conspiracy and threatened with lengthy jail terms for protesting against the testing of the Star Wars missile program.

Revenue Canada (internal revenue), meanwhile, refused charitable status to Greenpeace Environ-

mental Foundation, claiming that it served no useful purpose and that its campaigns against corporations could put people out of work. These examples have been seen as part of a concerted international attempt to suppress NGO protests.

As an organization, Greenpeace has been extremely successful in raising the profile of environmental issues and has been invited to join international conferences at the highest level. Greenpeace, like other NGOs, such as Amnesty International and Friends of the Earth, have helped to change people's understanding of democracy and of how they can effect change.

SEE ALSO

globalization; France; air pollution; water pollution.

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## grifters

CONFIDENCE MEN and grifters have always been part of society, but they are perhaps most identified in the 19th century with the circus grifter and the riverboat gambler, and in the early 20th, with the world of the Big Con games, most famously portrayed in the 1973 movie, *The Sting*, and later the 1990 movie, *The Grifters*.

The world of the traveling circus was tailor-made for the con men, including the shell-game artists and other fraudsters. The circus management cultivated this relationship, providing their midway as a venue, and a fixer to avoid arrest, all in exchange for a cut of the profits. Mississippi riverboats and the transcontinental railroad construction camps, justly famous for nurturing gambling and vice, were also fertile ground for grifters, a life detailed by George Devol in his memoir *Forty Years a Gambler on the Mississippi*. However, not all gam-

blers were grifters, and not all grifters were gamblers. David Maurer, a linguist who studied the con argot, defines grifter: "In the strict sense, one who lives by his wits as contrasted to the heavy-men who use violence," and further, identifies grifters as "professionals within the criminal world." The grift (noun) is defined by Maurer as "a racket or criminal profession or group of criminal professions which employ skill rather than violence." The grift might also be used to connote a fraternity of professional swindlers who relied on their wits.

A grifter did not simply cheat at cards, he went out of his way to concoct a scheme to entice a pre-vetted mark (victim) into a crooked (fixed) game at which the mark would be fleeced (relieved of funds), and followed up with a carefully rehearsed brush off (exit strategy), to put the mark off the trail.

Legendary con man Ben Marks is credited with developing the concept of the Dollar Store, or a fixed location at which to play-out these schemes, at a "hell-on-wheels" construction camp attached to the Union Pacific Railroad in 1869. Transformed into the Big Store, this basic concept led to increased specialization and efficiency in the world of the grifters. The big store could be any kind of fake establishment: betting parlor, horse parlor, stock brokerage, or office used to swindle a series of victims.

While late-19th-century grifters were commonly associated with the circus, by the first quarter of the 20th century, most of the grift fraternity was associated with the Big Stores operating in New York City, Chicago, Illinois, and a host of other congenial cities where the police and political establishment could be fixed. These included Los Angeles, California; St. Louis, Missouri; Hot Springs, Arkansas; Des Moines, Iowa; Miami, Florida; and Denver, Colorado.

At each location, an insideman, or fixer, maintained a permanent operation, employing a loosely organized mob of grifters which often traveled from one location to another. In the mobs that operated out of New York and Chicago, and other cities in the first quarter of the 20th century, the grift fraternity included men and a few women who performed specialized functions, including ropers (recruiters), who traveled widely, enticing the marks into a carefully scripted play, organized by the insidemen and the shills or "sticks," the supporting cast of players known collectively as the boost. In

practice, the boost was often made up on the spot by any roper in town at the time. It was this itinerant, specialized, professional fraternity which defined the grifter in the beginning of the century.

In contemporary usage, the term *grifter* is applied to any form of swindler or participant in schemes to defraud. Today's grifters range from the still-independent (though far fewer in number) freelance con artists to internet fraudsters pulling scams via e-mail.

#### SEE ALSO

scams; gambling and lotteries; federal gambling regulation; internet fraud; identity fraud.

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## Gulf Oil Corporation

THE U.S.-BASED Gulf Oil Corporation, formed in 1907, was the subject of major scandals about illegal campaign donations in 1973, and payoffs to foreign government officials in 1976. These revelations, and similar revelations about other major U.S. corporations, prompted public outcries about corporate behavior that led to the 1974 amendments of the Federal Election Campaign Act and the passage of the Foreign Corrupt Practices Act in 1977.

The origins of Gulf can be traced to the J.M. Guffey Petroleum Company established in 1901 to develop the Spindletop Oilfield in Texas. The founders of the company created the Gulf Refining Company to refine and market oil from Spindletop. In 1907, the two companies merged to form Gulf with noted capitalist Andrew W. Mellon as president.

For two decades, Gulf grew steadily, developing oil fields in Texas, Oklahoma, Louisiana, Mexico,

and Venezuela, and constructing pipelines linking these fields to four new U.S. refineries.

Investigators discovered that Gulf had made a series of illegal campaign contributions, including \$100,000 to President Richard Nixon's Committee for the Re-Election of the President (CREEP), and other donations of \$15,000 and \$10,000 to a representative of other candidates in 1972. In November 1973, Gulf pleaded guilty to making illegal contributions to the Nixon campaign totalling \$125,000.

The Watergate hearings prompted the newly formed Enforcement Division of the U.S. Securities and Exchange Commission (SEC) to investigate how Gulf and eight other corporations concealed their illegal contributions to the Nixon campaign. In 1975, the SEC prosecuted Gulf after discovering that the company operated a secret slush fund, laundering money through a Bahamian subsidiary. Gulf agreed to appoint a committee to investigate all political payments made by the company.

The Special Review Committee, chaired by the New York lawyer John J. McCloy, reported in December 1975. The report revealed that Gulf spent \$10.3 million on contributions, gifts, entertainments, and other expenses relating to political activities in the United States and abroad, including \$4 million given to the political party of South Korean President Park Chung Hee. As a consequence of the report, the Gulf board of directors demanded the resignations of their chairman and three other executives in January 1976.

The scandals added considerably to Gulf's existing woes about oil supplies. In 1975, the Kuwaiti

government nationalized Gulf's operations in that country. The scandal forced several key managers to resign, weakening Gulf's senior management at a time of crisis. Cautious, bureaucratic, and lacking in confidence, their successors did not provide clear and aggressive leadership required to improve the company's position. Gulf became a prime takeover target.

In 1983, T. Boone Pickens attempted to seize control of Gulf, but Gulf executives resisted Boone's takeover. In an attempt to save the company from being broken up, the board invited rival takeover bids. In 1984, the Gulf board agreed to sell the company to Chevron for \$13.2 billion.

#### SEE ALSO

Nixon, Richard M.; Watergate; campaign finance; Foreign Corrupt Practices Act.

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# H

## Hart-Scott-Rodino Act

AMENDING THE Clayton Act of 1914 (which covers stock acquisition in restraint of trade), the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR) (15 U.S.C. 18a) requires that certain proposed mergers of assets be approved beforehand by the Federal Trade Commission (FTC) and the Antitrust Division of the U.S. Department of Justice, the antitrust authorities in the United States.

Calls for legislation covered by HSR date back to the Dwight Eisenhower administration in the 1950s and Attorney General Robert Kennedy in the early 1960s. Prior to HSR, unfair restraint of trade related to stock acquisition could be prosecuted only after a restraint was found. The first set of rules became effective on July 31, 1978, and has been amended by both antitrust authorities numerous times to improve the program's operations and lessen the paperwork burdens of filing.

Those subject to filing proposed mergers must generally wait 30 days (15 days for cash tender offers and bankruptcy sales) for the antitrust authorities to determine whether the intended merger will adversely affect a marketplace. Whether a given acquisition is subject to HSR depends on its value, and, in some cases, the size of the parties measured by their assets or sales. If either antitrust authority

believes that more information is needed to investigate the application, it can extend the 30-day period for another 30 days (10 days for cash tenders and bankruptcy sales), and require a second request for pre-merger documentation. About 3 percent of all proposed mergers involve a second request. When the government believes that a marketplace will be adversely affected—either by increasing consumer prices or decreasing the quality of consumer products or services—it will request in federal court an injunction against the merger.

On February 1, 2001, major changes to HSR took place, including raising the acquisition value for reporting pre-merger activities from greater than \$15 million (in acquired assets or voting rights) to greater than \$50 million; this threshold also applies to acquisition of foreign assets and voting rights). A much more expensive fee structure was created—\$45,000 for transactions valued at less than \$100 million, \$125,000 for transactions valued at \$100 million to less than \$500 million, and \$280,000 for transactions valued at \$500 million or more. The 2001 amendment also contained other technical changes in requirements for HSR reporting.

Beginning in 2005, the minimum acquisition value is adjusted by the percentage increase or decrease in the “gross national product” from the previous year. The 2001 change immediately led to a 50 percent decline in the number of premerger investi-

gations (from 4,926 in 2000 to 2,376 in 2001). Although the number of pre-merger investigations declined substantially, the government still reviews the largest proposed mergers ever, some of which have involved multiple trillions of dollars. Reports of pre-merger stoppages are published annually by the Federal Trade Commission in its *FTC HSR Annual Report to Congress*, mandated by 15 U.S.C. 18a(7A)(j).

To find pre-merger situations that violate the act based on failures to file an HSR report, the antitrust authorities examine newspaper and industry publications, and rely on complaints from consumers, stockholders, and competitors. Failure to file a required HSR report carries a fine of \$11,000 per day. Opponents of HSR claim that the exorbitant fees required charge businesses for services they do not want, and are analogous to fines levied against businesses for crimes they have not committed.

#### SEE ALSO

Clayton Antitrust Act; antitrust; Federal Trade Commission.

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## Hartung-Burgess Debate

SHORTLY AFTER Edwin H. Sutherland helped introduce the world of criminology to the topic of white-collar crime, a number of pioneering research studies soon followed. In their own unique way, each of these studies attempted to resolve the definitional controversies surrounding the white-collar crime concept.

Some criminological researchers sought to refine Sutherland's early definition by narrowing the scope of white-collar crime and focusing on a limited number of offenses. Comparatively, other criminologists took the concept of white-collar crime and tried to expand it, arguing that the term could

apply to even a greater number of offenders and offenses.

Beginning with the pioneering work of Sutherland, early criminologists recognized that white-collar crime is difficult to study, regardless of how it is defined. While researchers focusing on violent or common crimes had several official sources of data (such as the Uniform Crime Reports and other police documents) available for use in their research, those studying white-collar crime were not afforded such a luxury. Given the difficulties associated with obtaining representative, white-collar crime data, many researchers following Sutherland turned to a relatively new approach: the case study. Unlike the more traditional, positivistic approach to social science and criminological research whereby a large sample of offenders is used to test theory and make limited inferences about some phenomenon, the case study is based on a detailed examination of a single case.

#### OFFENSES AND OFFENDERS

Taking the case study to the industry level, criminologist Frank E. Hartung focused his white-collar crime research on the Detroit, Michigan, meatpacking industry during World War II. In his attempts to address the ongoing definitional debates of the time, Hartung examined offenses as well as offenders. He questioned whether violations of wartime regulations could be considered white-collar crime, and argued that they could. As a result, he also questioned whether those offenders who committed the violations could be viewed as white-collar criminals. Hartung's resulting opinion on this issue was also affirmative, based on the evidence from his research.

Among other criminologists studying white-collar crime, Hartung's research was welcomed as major contribution to the literature. However, it drew considerable criticism from one of the most prominent sociologists of the time: Ernest W. Burgess. A well-known and respected Chicago School researcher, Burgess maintained that wartime regulatory violations were not white-collar crime. Similarly, he argued that the individuals who committed such acts were not white-collar criminals because they did not view themselves as criminals.

Burgess also attacked the validity of Hartung's research by stating that well over half of Americans were likely involved in wartime regulatory viola-

tions, and that it would be impossible that such a large segment of the population could not all be viewed as criminals. Hartung, and other scholars, had understandable difficulty with Burgess' proposition that a person is not a criminal if she does not view herself in that light. However, Hartung's research arguably made a contribution to the study of white-collar crime, and subsequent criminologists followed his lead in conducting in-depth studies of specific industries.

#### SEE ALSO

Sutherland, Edwin H.; World War II; differential association; elite crime.

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## Hays, Wayne (1911–1989)

IN MAY, 1976, Wayne Hays, a 14-term Democratic Congressman from Ohio, was considered one of the most powerful members of the U.S. House of Representatives. As chairman of the House Administration Committee, he controlled members' campaign funds and office allowances. He also became the center of intense controversy when the *Washington Post* published a story alleging that Hays placed his mistress in a \$14,000-a-year staff job with the House Oversight Subcommittee in exchange for sexual favors.

Hays acknowledged that he had a "personal relationship" with the woman but claimed that there had been nothing illegal about her employment. He insisted that she was paid for work actually performed by the subcommittee. The Department of Justice immediately began investigating the matter for possible violations of federal laws covering conspiracies to defraud the government or to convert public funds to private use. The woman, apparently reveling in her sudden notoriety, became a favorite

interview subject for inquisitive reporters. She effectively refuted Hays' claim that she was a valuable employee when she admitted that she did not know how to take dictation, or type, or even answer the telephone in her "office." Five months after the story broke, Hays resigned from Congress. The Justice Department quickly dropped its investigation, as did the House Ethics Committee, which had also been looking into the matter. In October 1976, a federal judge, at the request of the Justice Department, threw out of court three suits brought against Hays by taxpayers seeking to recover the public funds used to pay the salary of Hays's mistress. Hays died in 1989.

#### SEE ALSO

corruption; embezzlement.

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## hazardous waste

HAZARDOUS WASTE is industrial waste that the Environmental Protection Agency (EPA) designates as dangerous to the environment or the public health. The EPA mandates that hazardous waste be managed and disposed of using specific methods. There are five methods used to treat hazardous waste including being deposited in a deep well, a pond, a landfill, the ocean, or in an incinerator, detoxified, recycled, or reused.

Unfortunately, 68 percent of the hazardous waste in the United States is managed by disposal, 5 percent is burned, and 5 percent is recycled. Industrial facilities that produce hazardous waste are required to handle and store the waste properly and either treat it themselves, or transport it to other sites with legal permits to treat or dispose of the waste. Between 700,000 and 1 million hazardous-waste generating facilities exist in the United States.



These facilities produce 1.1 trillion pounds of hazardous waste. The EPA reported in 1990 that approximately 211,000 of these hazardous waste facilities were in direct violation of the Resource Conservation and Recovery Act.

Congress enacted the Resources Conservation and Recovery Act in 1976 to regulate hazardous waste generation, management, and disposal. Toxic waste-generating facilities or manufacturing companies are greater than the 2,025 facilities that exist to dispose or treat the waste. Additionally, it is quite common for many of these waste-generating facilities to perform illegal operations, such as the 22-percent of hazardous wastes that are discharged into streams and sewers. Facilities that specialize in the management, but not the generation of hazardous wastes, are called treatment, storage, or disposal facilities, or TSDFs, but they handle only about 2 percent of the hazardous waste produced. Most research examining hazardous waste has focused on these TSDFs that are under much more stringent legal standards than the facilities that generate the waste. Research examining TSDFs reveals that such facilities are more likely to be placed in areas with poor households or in predominantly minority areas.

### SUPERFUND

In 1980, the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) was enacted to clean up the most dangerous of discovered abandoned toxic waste sites. This act created the Superfund, bankrolled by special taxes on petroleum and chemical industries, which waived federal government sovereign immunity so states could sue the federal government. The CERCLA was amended in 1986 by the Superfund Amendments and Reauthorization Act (SARA) and mandated an inventory of all discovered potentially hazardous abandoned hazardous waste sites. Most of these are former manufacturing plants, mineral mines, federal ammunition dumps, chemical waste ponds, or municipal landfills; some of these were legal dump sites some illegal.

There are between 4,000 and 50,000 illegal hazardous sites created on a daily basis in the United States alone. According to the U.S. government, there are over 16,000 active landfills containing hazardous wastes and underground landfills in rural areas that will eventually breach and penetrate the

soil. Poor rural areas already contain thousands of landfills and underground storage sites that are already contaminated and leaking. Chemical wastes leach from disposal sites and leak into community water supplies. Specifically, the EPA reports that 74 percent of the Hazardous Waste Sites (HWS) are associated with groundwater, the primary source of drinking water in the United States.

This contamination primarily includes heavy metals and organic solids. These sites have been prioritized and ranked in terms of degree of dangerousness and subsequently end-up on the National Priorities List (NPL). As of 1997, this list contained 1,400 of the most dangerous HWS in the nation scheduled for cleanup. NPL sites are paid for by the previously collected fund from taxes on big business and EPA lawsuits against polluting companies. These are also called Superfund sites.

### CORPORATE CRIME

Environmental crimes often involve the use of organized crime syndicates to illegally manage the toxic waste produced by some of the nation's most frequent environmental offenders including, General Electric (GE), Westinghouse, Ford, DuPont, the U.S. government, and Union Carbide. Estimates indicate corporations illegally dump about 8 million tons of toxic wastes into rivers and coastal waters annually. GE is responsible for hazardous waste contamination at more than 200 Superfund sites. The nation's most polluted site may be Rockwell International's facility that manufactures nuclear weapons in Rocky Flats, Colorado, where approximately 166 hazardous waste sites have been found.

Oil companies are chronic offenders and account for half of the hazardous waste problems across the country. Environmental crimes also involve the poisoning of the world's poorest peoples through use of U.S.-banned pesticides, in addition to the export of banned toxic waste to third world nations. David R. Simon points out that many of these environmental crimes go unreported by traditional media outlets. In the United States, there are more than 50,000 abandoned hazardous waste sites, and over 1,200 of these remain a risk to human health and have been placed on the NPL of the government's Superfund program.

Most of the 5,000 active hazardous waste sites are required to conduct extensive cleanups as mandated under the 1976 Resource Conservation and

Recovery Act. There are approximately 295,000 locations where hazardous waste is stored in leaky underground storage tanks that contaminate groundwater resources. The largest 100 of these hazardous waste facilities generated six times more hazardous wastes than the remaining facilities.

## LOVE CANAL

The worst hazardous waste crime in U.S. history occurred at the Love Canal site in western New York. Hooker Chemical and Plastics Company dumped approximately 27,000 tons of toxic and cancer-causing chemical waste into the canal from 1942 to 1953. Similarly, an abundance of research reveals that across the country, counties with hazardous waste sites have significantly higher mortality for lung, bladder, esophagus, stomach, large intestine and breast cancers than counties without hazardous waste sites.

During an excavation at Love Canal, the chemicals were discovered to be leaking from corroded drums into sewers, gardens, basements, and a playground contaminating over 900 homes and an elementary school. In 1979, the area was declared a federal disaster area by President Jimmy Carter. This environmental calamity resulted in the 1980 Comprehensive Environment Response and Comprehensive and Liability Act.

Hooker committed a similar offense in Hicksville, Long Island, New York, where its plastics manufacturing company produced and shipped the toxic solid waste released in the process of making plastic, called polyvinyl chloride (PVC) from 1946 to 1968. This substance causes liver cancer, degenerative bone disease, and respiratory problems. Basically, Hooker shipped 478,300 pounds of PVC from one municipal landfill to another. The waste eventually ended up at a landfill in Brentwood, New York, where it contaminated drinking wells belonging to Grumman Aerospace Corporation's plant adjacent to the landfill. Hooker also secretly dumped toxic waste stored in leaky barrels in White Lake, Michigan, resulting in birth defects, cancer, and sterility, among nearby residents. Hooker Chemical committed multiple additional environmental crimes prior to advent of environmental waste legislation.

Another problem with the disposal of hazardous wastes is the placement of facilities in predominantly poor or minority neighborhoods. One



*A "paint waste area" is shown in promotional materials for a waste clean-up company in Savannah, Georgia.*

government study found that newer TSDFs were more likely to be located in minority and lower-income neighborhoods, particularly in heavily populated urban areas, and that it is the smaller hazardous waste facility that is often more likely to illegally dispose of its waste. In response to this information, the EPA declared in 1994 that environmental equity would become one its top priorities. Subsequently, President Bill Clinton signed Executive Order 12898 requiring federal agencies to address environmental justice with regard to minority and poor communities.

## STUDY ASSESSMENTS

According to the EPA, 60 percent of hazardous waste received at the TSDFs is from another state and 80 percent at the county level is from another county. In 1997, the first piece of research aimed at studying a national tract-level analysis of equity in the distribution and prioritization of abandoned toxic waste sites was published. The research examined the differences in the demographic characteristics of neighborhoods with NPL sites and those with the Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS) sites not yet on the priority list.

This process is such that, after citizens or agents of the EPA (state or federal) discover a potential hazardous waste site, the EPA investigates and records the location of the site on the CERCLIS database. Once recorded, it is scheduled for prioritization review or investigation and possible listing on the NPL. After the investigation, sites deter-

mined to be harmless are removed from the CERCLIS. Those that are hazardous are scored by the Hazardous Ranking System assigning a score, indicating the level of risk involved. Sites with scores beyond a certain threshold are placed on the NPL, and are further investigated and then prioritized again for remediation by the specific environmental offender.

The research findings revealed that in densely populated metropolitan areas, neighborhoods with an average percentage of Hispanics (7 percent) and African-Americans (11 percent) were more likely to have increasing numbers of CERCLIS sites. CERCLIS neighborhoods were more likely to have fewer college-educated persons and more industrial workers living in the neighborhood. This was true in metropolitan and rural areas. Another fact is that every 1990 census-defined metropolitan area had at least one CERCLIS site located in it.

In examining whether or not inequity existed in the distribution of NPL sites, researchers found that poorer neighborhoods, neighborhoods with a greater percentage of Hispanics, African Americans, and poor people were less likely to end up on the NPL while more densely populated neighborhoods were more likely to end up on the NPL. Finally, on average CERCLIS locations are on the list for about 5.5 years from the time of discovery to placement on the NPL.

In a very sophisticated analysis by Douglas Anderton and John Michael Oakes found that as the percentage of African Americans and poor families increased the time associated between discovery and National Priority listing increases. Other research found that, in Florida, a higher percentage of African American and Hispanics were more likely to live near the site.

Further research found that, over time, the percentage of African Americans and Hispanics living in or near these Superfund sites increased from 1970 to 1990, supporting their indirect discrimination thesis. That is, African Americans are constrained to live in areas with diminished economic value as the result of adjacent NPL sites (most NPL sites in Florida were placed on the list in the late 1980s). Thus, the data indicate class and racial inequality is institutionalized into the construction and labeling of sites as Superfund sites or NPL sites. Proportionately, more white, better-educated neighborhoods are more likely to have hazardous waste sites in their areas more rapidly placed on the NPL

for clean up. It should be noted that NPLs were also more likely to be located in metropolitan areas, but then 75 percent of all NPLs are located in metropolitan areas. Interestingly, the average cost of cleanup at each NPL site is about \$27 million.

## INTERNATIONAL WASTE

Hazardous waste proliferation is becoming an international problem particularly among developing and third world nations. Specifically, the United States and European nations export toxic waste to developing nations to reduce costs and increase profits. This internationally institutionalized pattern of behavior is revealed by an internal memo written by an economist for the World Bank, suggesting exporting more toxic waste to peripheral nations. This environmental exploitation of poor, developing nations thus appears to be motivated by the same considerations influencing the placement of polluting industries or toxic storage facilities in U.S. communities, that is, greater levels of poverty or economic inequality translate into lower costs for corporations and minimal enforcement standards, or the total absence of legal prohibitions.

For example, industries that produce hazardous waste, while required to meet certain environmental standards in Western industrialized nations, face regulations in developing nations that are lax, and where social protests against environmental degradation and pollution are weak or nonexistent. Thus, transnational corporations can act with impunity in damaging the land, water, and air in developing nations. More recently, transnationals have been able to sell their corporations' clean-up operations and profit from those sales, even though it was their industry that created the environmental problem in the first place. Moreover, the U.S. government's International Development Agency has given \$117 million to U.S. industries to aid in the environmental clean-ups in Asian, African, and South American countries. Although the 1989 and 1994 Basel Conventions banned waste trade (or dumping) between industrialized nations and third world nations beginning in 1997, it did not prevent the sale of such industries.

## SEE ALSO

Love Canal; Union Carbide; Environmental Protection Agency; General Electric; Africa; Asia; South America; globalization; capitalism.

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## Health Corporation of America

THE LARGEST FOR-PROFIT hospital chain in the United States, Hospital Corporation of America (HCA) runs more than 200 hospitals and surgical centers in 24 states, as well as operates holdings in both England and Switzerland. HCA had been under investigation by the U.S. Justice Department for years when on July 26, 2003, the Justice Department announced that HCA had agreed to pay the government \$631 million in civil penalties and damages for false claims to Medicare and Medicaid. Included in the charges against HCA were cost reporting frauds and payment of kickbacks to doctors.

"Health care providers and professionals hold a public trust, and when that trust is violated by fraud and abuse of program funds, and by the payment of kickbacks to the physicians on whom patients and programs rely for uncompromised medical judgment, health care for all Americans suffers," said

Assistant Attorney General Robert D. McCallum Jr., who headed in 2003 the Justice Department's civil division.

In December 2000, HCA subsidiaries pleaded guilty to criminal misconduct and paid \$840 million in fines, restitution, and penalties. In addition, HCA agreed to pay \$250 million to resolve overpayment claims in its cost-reporting practices. All together, the Justice Department recovered more than \$1.7 billion from HCA, the largest recovery ever in healthcare industry fraud investigation. This settlement covered nine fraud accusation lawsuits against HCA. The government claimed that HCA systematically defrauded federally funded health care programs, including Medicare and Medicaid. Eight whistleblowers, including a physician, filed suit in 1995 and will, as of 2003, receive \$157.6 million.

## THE UNINSURED

On July 16, 2003, the Consejo de Latinos Unidos released a report charging HCA with illegal collection practices against the uninsured, as well as systematically over-charging the uninsured by \$2.1 billion in 2002. "Let this case be a continuing reminder to all that in the fight against healthcare fraud this office will not be deterred," said Acting Principal Deputy Inspector General Dara Corrigan in 2003. "Medicare dollars paid to provide ever more expensive healthcare services to the country's taxpayers should never be fraudulently diverted. This is our job and our trust and we take these duties very seriously." Corrigan concluded.

The Department of Justice relates, in a separate agreement, HCA agreed to pay \$1.5 million to resolve allegations that an Atlanta, Georgia, hospital, West Paces Medical Center, paid kickbacks for the referral of diabetes patients. On July 21, 2003, HCA announced that it had finalized an agreement with states having claims similar to those of the Department of Justice. HCA will pay \$17.7 million to state Medicaid agencies to settle those claims, according to Health & Medicine Week.

SEE ALSO  
healthcare fraud; Medicare and Medicaid fraud.

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## healthcare fraud

THREE BILLION DOLLARS are spent each day on healthcare in the United States, and over four billion healthcare insurance transactions are processed each year. Of these transactions, a small percentage of them are fraudulent. Estimates from the Centers for Medicare and Medicaid Services suggest the healthcare spending will account for 17 percent of the gross domestic product by 2011. When all is said and done, it is estimated that between \$39 and \$100 billion is lost to fraud and abuse in healthcare each year.

The Springfield, Illinois, division of the Federal Bureau of Investigation (FBI) in 2003 defined healthcare fraud as "knowingly executing or attempting to execute a scheme or artifice to defraud a health benefits or insurance program or the willful execution of a scheme to defraud a care recipient." A similar definition of healthcare fraud is offered by the National Healthcare Anti-Fraud Association (2003), which defined healthcare fraud as "the deliberate submittal of false claims to private health insurer plans and/or tax funded health insurance programs, such as Medicare or Medicaid."

State and federal governments began their attack on healthcare fraud in the early 1990s. In 1992, the Healthcare Fraud Unit was established by the FBI within its Financial Crimes Section. The unit is not designed to investigate crimes per se, but to provide support and assistance to field offices that are working on cases that may spread across the nation. A few years later, in 1995, Attorney General Janet Reno announced that the response to healthcare fraud would be "the number-one priority of the Department of Justice."

There are at least three related reasons why concern about fraud and abuse in the healthcare field escalated in the 1990s. First, increased costs in administering healthcare caused great alarm and

politicians, policy makers, and criminal justice officials recognized that a significant proportion of those costs were due to illegal activities. Second, legislative initiatives called for strict enforcement of criminal activities in the healthcare field. Third, significant changes in the enforcement strategies available to criminal justice officials allowed for increases in the number of healthcare fraud prosecutions.

The passage of the Health Insurance Portability and Accountability Act (HIPAA) of 1996 was one legislative initiative that allowed for stronger responses to healthcare fraud. The act created a specific criminal offense for healthcare fraud and added these offenses to money laundering statutes. In addition, the act allowed authorities to implement criminal forfeitures, meaning they could seize money, property, or other profits offenders gained from the healthcare offense. The act was also significant in that it strengthened the government's ability to "kick providers out" of various benefit programs if they committed healthcare fraud. HIPAA was backed up with a significant and constant amount of funding. Essentially, the government's power to respond to healthcare offenses expanded significantly under this act.

Perhaps the most significant aspect of HIPAA was that it required the attorney general and the Department of Health and Human Services to work together in creating the Healthcare Fraud and Abuse Control Program. The program was designed to coordinate federal, state, and local responses to healthcare fraud. The goals of the program were the following: punish offenders; deter others from misconduct; protect patients; protect the integrity of the Medicare Trust Fund; educate patients and providers; and foster communication among agencies. If the increases in healthcare fraud prosecutions are any indication, HIPAA certainly was a success.

To fully understand healthcare fraud, attention should be given to the types of healthcare fraud, the response to healthcare fraud, its consequences, and the future of healthcare fraud.

### TYPES OF HEALTHCARE FRAUD

Several different types of healthcare fraud are perpetrated against the healthcare system. A non-exhaustive list of these offenses includes the following: phantom billing; upcoding; performing unnecessary services; misrepresenting treatments;

double billing; unbundling; illegal kickbacks; and billing for services provided by untrained/unlicensed individuals. These offenses and examples of each are described below. Note that these offenses can be committed in just about any branch of healthcare.

*Phantom billing.* A provider bills for services that were never provided to the patient(s). Example: A doctor bills for numerous sonograms that were never given.

*Upcoding.* A provider bills for more extensive services than were actually provided to the patients(s). Example: A dentist bills for a root canal, but actually simply filled a cavity.

*Performing unnecessary services.* A healthcare provider provides services that the patient does not need. Example: A cosmetic surgeon performs a breast reduction and bills the insurer on the grounds that the services were medically necessary.

*Double billing.* A provider bills more than one agency or patient for services. Example: A home healthcare nurse bills Medicaid and the patient the same amount for the same services.

*Unbundling.* Services that are supposed to be covered as a package are billed separately. Example: A hospital bills for specific services for a pregnant woman that are supposed to be billed as a package.

*Illegal kickbacks.* Healthcare workers provide funds or services in exchange for referrals. Example: A nursing home pays a hospital discharge employee for referrals made to the nursing home.

*Billing for services provided by untrained/unlicensed providers.* Workers who are not authorized to perform certain services do so anyway. Example: An nurse provides services that are supposed to be provided by a doctor.

*Drug theft.* Healthcare workers steal medicine or supplies but bill the insurance company as if those were provided to patients. Example: A pharmacist steals codeine and bills Blue Cross/Blue Shield.

*Pingponging.* Providers refer patients to other healthcare services simply to do other providers a favor. Example: A general practitioner sends a patient to cardiologist when the additional services are not needed.

## CASE STUDIES

Sometimes it is clear that healthcare fraud has occurred. Here are a few examples, descriptions of recent healthcare fraud cases described in the *Health-*

*care Fraud Report* in which it was clear that inappropriate activity occurred:

Pennsylvania Blue Shield, the Medicare carrier for several mid-Atlantic states, resolved a 2-year investigation by agreeing to pay \$38.5 million in settlement of allegations that it improperly processed Medicare secondary payer claims, neglected to recover overpayments, bypassed certain computer payment safeguards, and failed to implement required screens for certain lab tests, all of which resulted in false claims to the Medicare program. Again, the contractor agreed to undertake corporate integrity obligations, including training and external reviews of its performance.

On February 27, 1998, in the Southern District of Mississippi, the owners of Gieger Transfer Services, an ambulance company, were sentenced to 80 months in prison and ordered to pay restitution of \$228,917 and a \$12,500 fine. The defendants billed Medicare \$400 per ambulance trip, claiming that patients taken on non-emergency ambulance trips were “bed confined” when, in fact, many could walk and had no need for ambulance transportation.

On February 20, 1998, in the Middle District of Florida, the owner/operator of the Tampa branch of the Florida Impotence Clinics, Inc., was sentenced to 27 months in prison and restitution of \$925,779. The defendant had pleaded guilty to having been engaged in a conspiracy to receive kickbacks for referrals to suppliers of diagnostic testing services. The owner received \$30 for any vacuum constrictor device used to treat impotence which was paid for by Medicare and sold by any clinic associated with the company.

Between July 8, 1997, and February 18, 1998, in the District of Massachusetts, six men were sentenced to various jail terms and ordered to pay \$3.5 million in restitution for defrauding eight non-profit mental healthcare companies that provided services to de-institutionalized mentally retarded individuals in six states and Washington, D.C. The men formed a fictitious management company to provide contract services to group homes for the mentally ill. The men received payments from the Medicare and Medicaid programs for services not rendered.

While wrongdoing was clearly established in each of these cases, whether activities are fraudulent or not is not always clear. The office of inspector general, for example, says that the following activi-



*Consequences of healthcare fraud include: 1) a loss of trust in healthcare officials, 2) inadequate healthcare, 3) deprivations of healthcare, and 4) physical harm from unnecessary services.*

ties are potentially unlawful: Hospitals paying incentives to physicians every time they send them patients; allowing doctors to use free or discounted space near a hospital; providing free or discounted services to services to physicians' staff; providing low-interest loans to physicians in exchange for referrals; providing free training for physicians' staff members.

Healthcare providers routinely claim that the vague nature of the statutes governing their activities makes it possible for authorities to become overzealous in enforcing healthcare fraud statutes. A consideration of the response to healthcare fraud can help determine whether enforcement can be characterized as overly aggressive.

#### RESPONSE TO HEALTHCARE FRAUD

Authorities control healthcare fraud in three different ways—through criminal remedies, civil processing, and administrative hearings. Yvette Mastin uses

the phrase *triple proceedings* to refer to the fact that providers could face proceedings in all three of the areas. Criminal justice processing of these cases increased dramatically in the mid-1990s. Changes in the way the FBI responded to healthcare fraud between 1992 and 1999 were dramatic. The number of FBI agents assigned to investigate healthcare fraud increased nearly fivefold in the 1990s, from 112 in 1992 to 500 in 1999. As a result, the number of criminal healthcare fraud investigations by the FBI increased from 502 to 3000, and the number of convictions from 116 to 548 between the same years.

It was not just the FBI, though, that was involved in the response to healthcare frauds. Others that are active include the following agencies: the United States Postal Service, the Internal Revenue Service, Defense Criminal Investigative Services, Medicaid Fraud Control Units across the states, the U.S. Attorney General, the Department of Public Health, and the office of inspector general. In addi-

tion, private insurers have their own investigation units designed to detect, prevent, and root out fraud in their agencies.

Investigators and prosecutors will face a number of obstacles when they bring criminal charges against healthcare providers. For instance, healthcare providers generally have a great deal of resources that allow them to hire the best attorneys who are able to put together the best defense possible. Investigators continue to face funding shortfalls and outdated computers that make their search for evidence cumbersome. They also must gather a plethora of records in order to substantiate that fraud occurred. According to Mark Taylor, the average healthcare fraud case “can entail 50 boxes of evidence, with each 1-foot-by-2-foot box containing 3,000 to 5,000 pages of information.” Having to sort through all of this evidence and find witnesses willing to talk about sensitive issues slows the criminal prosecution process.

Another problem that arises in criminal prosecutions of healthcare cases is one of proof. Prosecutors must prove beyond a reasonable doubt that a crime was committed. Providers routinely claim that the inappropriate billings were simply accidents committed by someone working in their billing office. It is an uphill battle to convince a judge or jury that the provider was responsible for the fraudulent claims submitted to the insurance company.

Despite these obstacles, criminal prosecutions have proven to be a success and a lucrative response to fraud. In terms of success, over half of offenders convicted of healthcare fraud at the federal level receive prison sentences. Also note that the Department of Justice was able to exclude 3,000 providers convicted of wrongdoing from participating in Medicare and Medicaid in 1998. In terms of the lucrative nature of the response to healthcare fraud, in 1998 the Department of Justice alone recovered nearly a half-billion dollars in its response to healthcare fraud.

Authorities will also rely on civil prosecutions to bolster the response to healthcare fraud. In these cases, the government essentially become the plaintiff and files suit against the defendants, who may be providers, businesses, or groups of organizations. Officials commonly file civil charges against providers under the False Claims Act. This act was created during the Civil War to help the government go after gunpowder manufacturers who were

wreaking havoc by selling sawdust instead of gunpowder. Today, the act is used to “create liability for defendants who act against the government by presenting, or through the presentation of, a false or fraudulent claim for payment or approval,” explains Mastin. In using this act, the plaintiffs do not have to prove that the provider intended to defraud the healthcare system; rather, they simply have to approve that the system was stolen from.

False Claim Act cases are also appealing because of their economic nature. Basically, providers can be ordered to pay treble damages, meaning that they



*A doctor's referral for unnecessary services or surgery constitutes healthcare fraud.*



have to pay three times that amount that they stole in addition to any fines they received on specific charges. This can represent an enormous “profit” for the government. In one case, for example, a pharmacist fraudulently obtained \$155 through 29 fraudulent bills. He was fined \$2,000 and his pharmacy was fined \$10,000. In another case, Fresenius Medical Care agreed to pay \$385 million to resolve accusations that the provider conspired to steal from Medicare. In all, the Department of Justice recovered \$2 billion through civil recoveries between 1986 and 1998. These figures are increasing: In 2001 alone, the Department of Justice brought in \$840 million in civil recoveries. Not surprisingly, healthcare fraud recoveries top the list in civil recoveries made by the federal government.

A growing number of civil cases against healthcare providers are the result of *qui tam* suits. In these lawsuits, which are also known as whistleblower suits, an individual not affiliated with the government files charges on behalf on the United States. The individual is given a percentage of the awards should the case result in a finding against the healthcare provider. While *qui tam* suits can be filed against virtually any type of business defrauding the government, half of all *qui tam* lawsuits involve accusations of healthcare fraud. They are seen as beneficial in that they help to identify activities that otherwise would go undetected.

The administrative response to healthcare fraud includes licensing agencies, state medical boards, insurance companies, or state or federal authorities which may hold hearings to determine whether wrongdoing occurred. The penalties that could be applied by these administrative agencies include fines, loss of license, or expulsion from the insurance program that was defrauded. The latter two penalties are especially severe because they basically mean that the healthcare provider can no longer operate. Most criminal justice experts agree that such criminal, civil, and administrative proceedings are cost effective in healthcare fraud cases. For every dollar spent on healthcare enforcement, \$8 is recovered by the government. In addition, the threat of liability is believed to keep many potential offenders from defrauding the healthcare system.

### CONSEQUENCES OF FRAUD

Most often, individuals think of the economic consequences of healthcare fraud, and these losses can

be quite high. Billions of dollars are lost each year to fraud in the healthcare field, far more than is lost to virtually all street crimes. It is important to note, however, that the consequences of healthcare fraud extend beyond these economic consequences. In particular, other consequences include: 1) a loss of trust in healthcare officials, 2) inadequate healthcare, 3) deprivations of healthcare, and 4) physical harm from unnecessary services.

The loss of trust is sure to result from most white-collar offenses, but it is more marked in healthcare fraud cases. Most people never expect healthcare providers to do anything wrong. When they do violate the law, the trust that members of society have in the healthcare field diminishes.

Inadequate healthcare and deprivation of healthcare are additional consequences of fraud in the healthcare system. There is only so much money available for healthcare in our society. If individuals are using the funds inappropriately, then others will not have the funds that are needed to obtain adequate healthcare, if they get any healthcare at all.

Physical harm can also result from unnecessary services. Cases of doctors leaving patients paralyzed, physically impaired, or even dead, as a result of unnecessary surgery occur at an alarming rate. Or, individuals may undergo severe stress worrying about tests their general practitioner told them they needed. The stress is unneeded, and the irony is that the stress can lead to health problems, which probably did not exist to begin with.

### FUTURE OF HEALTHCARE FRAUD

There are no expectations that healthcare fraud will magically disappear in the future. Types of fraud have been shifting to include internet-based healthcare fraud, cosmetic surgery fraud, and home healthcare fraud. Internet-based frauds are especially increasing. According to Tom Delaney, chief of the FBI's healthcare fraud unit, physicians are “trying to find ways to bill for electronic patient visits.” Another FBI agent claims that “staged auto accidents are also making a comeback.”

Another trend in healthcare fraud is the growth of compliance programs in businesses and companies wanting to prevent accusations of fraud or abuse. According to Bonnie Schreiber and other researchers, compliance programs develop in healthcare businesses for one of three reasons. First, some

executives may simply think it is the right thing to do and encourage their company to develop a compliance program. Second, some healthcare companies may develop a compliance program as a result of being convicted of an offense. Third, some healthcare companies may develop a compliance program in order to be able to bill particular insurance companies. Among other things, compliance programs entail increasing awareness about healthcare billing rules and regulations.

In order to continue to control fraud, Charles Grayson (1998) argues that several policies must be implemented. First, he suggests that it must be made clear which agency is responsible for fraud control in a particular area. Second, he suggests that authorities should adopt a problem-solving approach (that is, define the problem, assess solutions, implement strategies, and assess response) to control fraud. Third, he calls upon investigators to watch for early signs of fraud before offenders are able to bilk the system out of millions. Fourth, he suggests that every claim submitted should face a likelihood of being reviewed by authorities. Finally, he argues that resources should be reallocated so that healthcare fraud investigators and prosecutors have enough funds to lead the attack in the war on healthcare fraud.

It is important to point out that although a great deal of monies are lost to fraud in the healthcare system, most healthcare providers are honest workers who never even think about committing criminal acts. Instead, it is believed that a handful of professionals commit the vast majority of crimes against the healthcare system. That handful of offenders, however, is able to cause a lot of damage.

#### SEE ALSO

United States; medical malpractice; Medicare and Medicaid fraud; unnecessary surgery.

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## hoarding

HOARDING IS THE act of acquiring a large amount of a commodity in an attempt to increase the market price of the commodity to well above the price obtainable if there were many buyers and sellers in the market for the commodity. This type of market manipulation has also been attempted for several types of financial assets. Examples of goods that may have been manipulated in this manner include silver, oil, treasury bonds, and diamonds.

#### THE HUNT BROTHERS

In 1973, the Hunt family of Texas, possibly the richest family in America at the time, decided to buy precious metals as a hedge against inflation. At the time, private citizens could not legally own gold, so the Hunts began to buy an enormous quantity of silver. In 1979, the sons of patriarch H.L. Hunt, Nelson Bunker and William Herbert, together with some wealthy Arabs, formed a silver pool. In a short period of time they had amassed more than 200 million ounces of silver, equivalent to half the world's deliverable supply. When the Hunts had begun accumulating silver back in 1973 the price was in the \$1.95 per ounce range. Early in 1979, the price was about \$5. Late 1979 and early 1980, the

price was in the \$50s, peaking at \$54. Once the silver market was cornered, outsiders joined the chase but a combination of changed trading rules on the New York Metals Market (COMEX) and the intervention of the Federal Reserve put an end to the game. The price of silver began to slide, culminating in a 50 percent one-day decline on March 27, 1980, as the price plummeted from \$21.62 to \$10.80. The collapse of the silver market meant countless losses for speculators and the Hunt brothers declared bankruptcy in 1987. In August 1988, the Hunts were convicted of conspiring to manipulate the market.

### THE SALOMON SQUEEZE

Another example of an attempt to corner a market was the Salomon Squeeze. During the May 1991 two-year Treasury note auction, Salomon Brothers Inc., was in violation of the rules of the treasury auction procedure. They submitted some bids on behalf of customers without obtaining their authorization and, in the process, ended up controlling a major fraction of the May 1991 two-year note supply. During July and the first half of August 1991, government regulators launched a sweeping investigation of Salomon alleging the firm might have controlled 85 percent of the two-year Treasury notes that were auctioned on May 22, 1991. Treasury auction rules bar any one organization from buying more than 35 percent of a single issue at auction.

Treasury note prices commonly decline modestly right after auctions, when interest in the note sale fades. In a strategy designed to profit on the two-year note's trading pattern, many traders and arbitrageurs sell the two-year note short ahead of the auction. With most of the notes owned by Salomon Brothers after the May 1991 auction, the only way the short sellers could meet their delivery obligations was by buying the notes from Salomon Brothers at whatever price Salomon demanded.

### THE DIAMOND MONOPOLY

The discoveries of 1870–71 led to a great number of prospectors staking out diamond claims in South Africa, but Cecil Rhodes quickly brought about the merging of these interests into De Beers Consolidated Mines, Ltd. Established in 1889, De Beers, was an effective monopoly over the diamond indus-

try. The Illicit Diamond Buying Act, which limited the trade of diamonds to licensed buyers and imposed penalties for the possession of uncut stones without a license, further consolidated the monopoly position of the company. Most of the major diamond producers were forced to belong to or cooperate with the De Beers-led marketing cartel, which was formed to maintain the price of diamonds at a high level. De Beers, under Harry Oppenheimer's leadership (1957–84), maintained its dominant position in the industry by using its numerous worldwide companies to buy up new sources of diamonds and to control distribution of industrial diamonds and production of synthetic ones. Due to increased competition in the last decades of the 20th century De Beers' hold over the unpolished diamond market has decreased, and in 2000 the company announced it would end its policy of controlling diamond prices through hoarding and shift its focus to increasing sales.

### ROOSEVELT AND GOLD CONFISCATION

Governments have sometimes forbidden the hoarding of commodities by individuals. The most famous case of this type is President Franklin D. Roosevelt's confiscation of gold in the United States in 1933. Roosevelt believed that the gold standard was somewhat responsible for the banking crises of the 1930s (many economists believe the Federal Reserve's overprinting of money was the problem). With Executive Order 6102, Roosevelt made the ownership of more than \$100 worth of gold or gold certificates by any individual, partnership, association, or corporation illegal in the United States. All individuals and organizations were required to turn their gold over to the Federal Reserve System by May 1, 1933. Individuals who did not comply with this order were subject to a fine of up to \$10,000. Private ownership of gold in the United States for investment purposes was not relegalized until 1974.

### OIL COMPANIES AND PRICE CONTROLS

During the 1970s, U.S. oil companies were accused of hoarding oil in an attempt to inflate oil prices. While people were waiting in line for gasoline and many gas stations ran out of gas, there were reports in the news media about large numbers of fully loaded tankers standing offshore and full oil storage tanks around the country. These reports turned out

to be largely spurious; price controls, not hoarding were largely responsible for the oil shortage in the United States. Oil price controls were imposed in August 1971, which held down the supply of oil since many domestic sources and some foreign sources of oil could not be developed at a profit. After 1981, when price controls were repealed a major surge in domestic drilling and production occurred despite the fact that the U.S. government imposed an extremely high windfall-profits tax that deprived the oil companies of a major benefit of the repeal of price controls.

#### SEE ALSO

price fixing; illegal competition; cartels; antitrust; South Africa; Salomon Smith Barney; capitalism.

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## Hobbs Act

THE HOBBS ACT IS a federal anti-racketeering law that makes it a crime to interfere with interstate commerce by extortion, robbery, or physical violence as in 18 U.S.C.A section 1951. Passed into law in 1946, the Hobbs Act was designed to battle organized crime, particularly to combat racketeering in labor-management disputes. The statute is frequently used in connection with cases involving public corruption, commercial disputes, and corruption directed at members of labor unions. Extant proof of racketeering as an element of a Hobbs Act offense is not required

The Act proscribes a number of separate offenses: 1) robbery, 2) extortion, 3) attempted robbery or extortion; and 4) conspiracy to commit robbery or extortion. Each such offense also requires

the federal jurisdictional element of obstruction, delay, or effect on interstate commerce. Primary investigative jurisdiction of Hobbs Act violations lies with the Federal Bureau of Investigation. The Inspector General's Office of Investigations, Division of Labor Racketeering, U.S. States Department of Labor, is also authorized to investigate violations of the act in labor-management disputes involving the extortion of property from employers.

The policy (9-131.040) regarding the robbery section of the Hobbs Act explicitly states that it is "only to be utilized in instances involving organized crime, gang activity, or wide-ranging schemes." The term extortion is defined as the "obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence, or fear, or under color of official right." Importantly, "fear" as defined in the act is not restricted to bodily injury. Rather, it includes fear of property damage and of economic loss resulting from failure to meet the extortive demand. Thus, situations involving labor relations where union representatives threaten to initiate labor trouble or continue labor unrest unless certain payments are made for the representatives' personal use are violations of the Hobbs Act. Similarly, payments made by employers because they fear financial loss if work stoppages or strikes begin or continue, are violations of the Hobbs Act.

The latter category in the definition of extortion, "under color of official right," generally concerns a public official trading her official actions in an area in which she has authority in exchange for the payment of money. For instance, such practices might involve municipal officials demanding money from contractors in return for official city approval of projects. The Supreme Court recently held that the "government need only show that a public official has obtained a payment to which he was not entitled, knowing that the payment was made in return for official acts."

A Hobbs Act application can involve a firm that is substantially involved in interstate commerce and meets extortion demands, thus depleting the firm's assets. Courts have ruled this depletion of assets is an obstruction, delay, or effect upon interstate commerce as contemplated by the prohibitions of the Hobbs Act.

For example, a stereotypical organized crime case involving the extortion of a local bar owner was deemed a violation of the Hobbs Act because

the extortion had the effect of diminishing the owner's ability to purchase for resale liquor originating in interstate commerce.

The U.S. Supreme Court, in March 2003, reversed a high-profile U.S. Circuit Court of Appeals ruling that upheld a nationwide injunction against anti-abortion organizations for engaging in acts of extortion in violation of the Hobbs Act by conspiring to shut down abortion clinics. The Supreme Court ruled that there were no acts of extortion under the Hobbs Act.

#### SEE ALSO

extortion; Racketeer Influenced Corrupt Organizations Act; racketeering; organized crime.

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## Holley, Louis Malcolm (1949–)

ACCORDING TO a 2002 General Accounting Office (GAO) report, U.S. Postal Service deposits totaling \$65 billion per year are vulnerable to theft, robbery, and mishandling due to factors such as inadequate security and the failure to follow procedures. The official report was prompted by the circumstances of a large-scale postal facility theft in Arizona.

In June 2001, one Phoenix, Arizona, postal facility experienced \$3.2 million in such losses when it became the victim of the criminal acts of employee Louis Malcolm Holley. The GAO's examination of the Phoenix facility revealed several security problems, including a key to a cage with stored valuables that was left in the lock, as well as cameras that were not in use.

Holley, age 52 at the time, was a 28-year veteran of the postal service. On June 2, 2001, he promptly disappeared with his loot, which included coin, cash, checks, and money orders. Holley remained at

large for over two months, and was finally captured and arrested at a motel in a suburb of Seattle, Washington, on August 17, 2001. Approximately \$1.7 million in cash was recovered with Holley's arrest, with the remainder of the stolen deposits presumably destroyed. Holley was convicted of theft of public money, property, and records, and received a prison sentence of three years and five months.

What could have led up to such a massive theft? Several factors were identified in the investigation of this case. For instance, prior to 1997, local post offices regularly deposited their daily payments in the form of coin, cash, and checks with local banks. To save costs, the postal service began moving deposits by armed courier to central locations and then subsequently making deposits at commercial banks. The Phoenix facility where Holley's theft occurred was one such central location. The GAO report also revealed that the manager of the Phoenix facility had ignored security warnings from the Postal Inspection Service.

To prevent thefts like Holley's from occurring in the future, Congressional representatives requested tighter oversight of the postal service. In addition to losses of assets, failure to improve security may result in increased costs to the public, safety concerns for employees, and service disruptions.

#### SEE ALSO

embezzlement; corruption; employee crimes.

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## Home-Stake Swindle

THE HOME-STAKE Production Company was an oil-drilling tax shelter company based in Tulsa, Oklahoma. Its founder, Robert Trippet, was a well-educated Tulsa lawyer. Trippet's company began offer-

ing investments to the public in 1964. Home-Stake promised investors that their ventures were tax deductible. Investors were told to expect returns of at least three times the monetary value of their original investments. When Home-Stake did not deliver, lawsuits were filed against the company. Many of the plaintiffs were well-known Hollywood actors, actresses, and other television and entertainment industry personalities. The victims also included many top U.S. corporate executives.

An in-depth investigation by reporter David McClintick revealed that Home-Stake was a classic Ponzi scheme where money collected from late investors is used to pay off the early investors. The term comes from the late Charles A. Ponzi, an Italian immigrant and 1920s swindler who managed to fleece victims of more than \$15 million with his postal coupon scandal. McClintick referred to Home-Stake as “the biggest Ponzi scheme” due to the large number of would-be investors who fell for the swindle.

McClintick was originally tipped off to the scheme by a tax-lawyer friend. McClintick’s investigation suggested that, although Trippet appeared to be the mastermind behind the Home-Stake swindle, his close associates were also heavily involved. These included Kent Klineman, a New York tax lawyer who collaborated with Trippet to divert over \$3 million out of Home-Stake. Several other prominent lawyers and accountants were also part of the scheme, including David Melendy, Home-Stake’s financial vice president, who was well aware of the money mishandling problems.

McClintick also discovered that several U.S. law and accounting firms received payments from Home-Stake after advising several of their wealthy clients to invest in the company. Martin Bregman, a financial manager for many entertainment performers, provided the link to the vast number of celebrity investments in Home-Stake. Bregman received kickbacks after steering a multitude of clients toward Home-Stake.

After a thorough investigation, McClintick concluded that the numerous investors had been duped out of more than \$100 million. Although several of them did file lawsuits, Home-Stake convinced many of the earlier investors to cut their losses by donating their shares to charity. As a result of McClintick’s inquiries, as well as probing by officials, a Los Angeles federal grand jury investigated Home-Stake. In 1974, 45 counts of conspiracy, tax fraud,

securities fraud, and mail fraud were handed down against Trippet and 12 others.

#### SEE ALSO

Ponzi schemes; scams.

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## Hong Kong

A SMALL ISLAND and peninsula off the coast of China’s Guangdong province, Hong Kong was a British colony until 1997. The motivation for colonization was to open Chinese markets further to British trade and to facilitate the spread of opium within China. A number of large business organizations that were founded in Hong Kong or nearby regions had their origins in this trade, and Hong Kong remains a center for illegal international distribution of opium produced in Yunnan Province and mainland southeast Asia.

For almost all the second half of 20th century, Hong Kong acted as an outpost of capitalism uncomfortably close to communist mainland China. While politically inconvenient to the Chinese Communist Party, Hong Kong was nevertheless extremely useful to many influential Chinese who found that “round-tripping” their commercial ventures through nameplate enterprises in Hong Kong served to legitimize them. Much of the capital flowing into Hong Kong evaded official channels in one way or another.

The official trade figures of Hong Kong, which were themselves extremely large, served to hide the significant market for smuggling, which was active in all the markets in which mainland Chinese bought Western goods and those areas, such as rare animal parts for medicinal purposes, for which China could supply Hong Kong. There have been some suspicions more recently that Hong Kong banks, among others, have been the recipients of

funds illegally gathered by corrupt mainland officials. More generally, the process of underground banking, which has historically been of great importance to ethnic Chinese communities, is also believed to be widespread in Hong Kong.

The huge contrast between living conditions in Hong Kong and the mainland served to inspire many millions of Chinese to migrate to Hong Kong, often illegally, to seek their fortunes. Inevitably, the treatment they received as invisible workers varied considerably depending on the nature of their employers. Many more people were lured into the sex industry and domestic service, where they had poor access to the law in case of improper treatment. The sex industry was closely connected to organized crime groups and these were believed to maintain their freedom through bribery of officials.

The takeover of Hong Kong by the communist mainland suggests there is a danger of the suppression of the media and their ability to report crime. The danger of false reporting of information by politicized mainland sources was demonstrated during the SARS disease crisis of 2003 when accurate counts of victims were temporarily unavailable.

#### SNAKEHEAD GANGS

Hong Kong has also become a center for counterfeiting goods and for piracy of CDs and computer software, in common with many other cities in China and the region. It is also believed that some of the "snakehead" gangs that operate human-trafficking networks to move Chinese overseas are resident on the island. Certainly, some smaller aspects of the large shipping industry have been linked with piracy and fraud. Nevertheless, in common with Singapore, the Hong Kong business and legal systems have been based on British traditions and this has provided some safeguards with respect to white-collar crime. The extent to which the independence of Hong Kong's institutions will continue under mainland rule and, hence, the preservation of those systems in the current form, remains a contested issue.

#### SEE ALSO

Singapore; China; capitalism; United Kingdom; free trade; globalization; human trafficking.

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## Hoover, Herbert (1874–1964)

IN HIS INAUGURAL address on March 4, 1929, President Herbert Hoover told the American people that his top priorities for the next four years were prosperity and freedom. Hoover said that he was particularly concerned about high levels of unemployment. He believed that the national government should take a greater role in promoting education and public health. Many historians believe that if Hoover had served the country at any other time than the coming of the Great Depression, he might have been considered one of the best presidents.

Although it has received little attention historically, Hoover's greatest achievement as president may have been his reform of the federal criminal justice system. Hoover had a personal as well as a presidential interest in the administration of justice and was particularly determined to prosecute anyone who engaged in securities fraud and violations of antitrust laws. During the 1928 presidential election, Hoover had promised to conduct a scientific study of crime and law enforcement.

After his election, Hoover followed through, appointing a crime study commission and declaring war on white-collar and organized crime. Hoover targeted notorious criminals such as Al Capone, believing that they could be stopped by repeated attacks on their economic resources.

Prohibition was in full swing during the Hoover years, and the president ordered his Attorney General William D. Mitchell to make sure that violators of the 18th Amendment were prosecuted to the fullest extent. Hoover also hired noted prison authority Sanford Bates to oversee a complete overhaul of the federal prison system, with orders to make it more effective. The president was also determined to make the Department of Justice (DOJ)

more effective and ethical, instructing Mitchell to rid DOJ of corrupt and inept federal prosecutors and launching extensive investigations of all judicial nominees.

In the 1930 election, the Democrats regained control of the House of Representatives with a gain of 50 seats and a one-vote margin in the Senate, which gave them control of all party leadership positions. Ironically, Hoover was more comfortable with Democratic leaders John Nance Garner and Joseph Robinson than he had been with Republican leaders. In reality, a large number of Progressive Republicans were incensed about what they called Hoover's "do-nothing" policies. In December 1931, Congress passed a number of bills that Hoover supported, including the establishment of the Reconstruction Finance Corporation (RFC) to make loans to banks, insurance companies, railroads, and farm mortgage associations. The Glass-Steagall Banking Act was passed to deal with runs on banks that had affected credit throughout the country. The Federal Home Loan Bank Act established regional banks that were charged with providing loans for mortgages and housing construction. Even when he managed to work with Congress to pass a bill, Hoover frequently limited the way in which the bill was implemented.

## RED CENT

Under Hoover's direction, the RFC was secretly distributing millions of dollars a day in business loans. Congress complained that the president was willing to render relief to businesses, banks, loan associations, railroads, and foreign governments but was unwilling to give a "red cent to starving American women and children." Hoover also received a lot of criticism for the inequities in federal income taxes. While the working class was struggling to pay its share of taxes, millionaires like J.P. Morgan were sliding by without paying any taxes at all. It was only as the election of 1932 began to demand his attention that Hoover stopped vetoing appropriations for relief and signed a bill that allowed state governments to borrow from the RFC fund.

As the effects of the Depression worsened and Hoover seemed unable to provide the leadership the country wanted, the president was finally forced to accept the reality of his public image. Armed police were called out to protect him from mob violence as eggs and rocks were thrown at him. Some

members of mobs advocated hanging him. In the previous election, Hoover had carried 40 states. On November 8, 1932, he carried only six states. When the Great Depression overwhelmed the United States, Hoover was simply incapable of using innovative national government actions to deal with the crisis because he remained convinced that business and a free market in conjunction with state and local governments could see the country through economic mayhem.

## SEE ALSO

capitalism; bank fraud; securities fraud. corruption.

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## HUD scandals

THE U.S. HOUSING Act of 1937, also known as the Wagner-Steagale Housing Act, created the Federal Housing Administration, later known as the Department of Housing and Urban Development (HUD). Throughout its history, HUD has been instrumental in providing affordable housing to low- and middle-income Americans.

On the down side, HUD has been involved in so many scandals that most people equate the agency with government corruption, ranging from simple mismanagement to criminal activities. Because the agency doles out billions of taxpayer dollars, the temptation to grab a portion of the profits has proved irresistible to scores of HUD employees over the years.

## SECTION 608

HUD's first major scandal erupted over Section 608 rental housing, which allowed developers to make enormous profits at government expense. Section



608 of the National Housing Act of 1942, which had been created to provide rental housing for defense workers during World War II, was later extended to include housing for war veterans. The public's first inkling of the Section 608 scandal occurred on April 11, 1954, when the White House announced that the Commissioner of the Federal Housing Administration (FHA), Guy Hollyday, was resigning. The following day, President Dwight D. Eisenhower ordered federal agents to impound all FHA records dealing with the Section 608 program. The president acted in response to reports from the commissioner of the Internal Revenue Service (IRS) that a number of corporations which sponsored 608 rental housing were reporting large wind-fall profits from hundreds of projects negotiated by the FHA. The Federal Bureau of Investigation (FBI) had also notified the Eisenhower administration that a large number of American property owners had been victimized by dishonest dealers and salespersons who contracted for home improvement loans through HUD.

Investigators learned that throughout the history of Section 608, FHA employees at all levels had received gifts from developers seeking lucrative government contracts. At Christmas, developers had presented male field officers with liquor, fruit, cigars, turkeys, and neckties. Females had received nylons, scarves, candy, and fruit. Gifts for selected high-ranking FHA officials had included wristwatches, portable radios, and television sets. One developer in New Mexico hosted a ground-breaking celebration for an FHA official, then charged the construction project \$500 for the services of three "party girls."

Investigators learned that no effort had been made to avoid conflicts of interest, and many FHA employees held interests in companies that contracted with HUD. The Special Investigation Office of the Housing and Home Finance Agency (HHFA) that had been appointed by Eisenhower to investigate the FHA scandal identified at least 1,410 projects in which proceeds from mortgages were higher than reported costs, with a total in excess of \$110 million.

#### SECTIONS 235 AND 236

During the 1960s, as part of President Lyndon Johnson's War on Poverty, new emphasis was placed on providing housing for poor Americans.

FHA was assigned the responsibility of providing subsidized homeownership under Section 235 of the housing act and to support subsidized rental housing under Section 236. While concentrated attempts were made to curtail opportunities for scandal, a December 1970 staff report to the House Committee on Banking and Currency documented various scandals within the housing agency. In response, each field office director, chief underwriter, and chief appraiser was ordered to visit at least five inner-city projects. Results were reported at a meeting with HUD Secretary George Remney, leading to the suspension of the Section 235 home mortgage program until an investigation could be completed.

One of the worst examples of abuses uncovered by Remney's investigation concerned what became known as the Paterson Tavern Case. The house in question had been built around 1900 in Paterson, New Jersey, and was later turned into a tavern. In October 1969, the house was condemned; however, the owner later sold it for \$1,800. The new owner then paid \$450 for electrical repairs and sold the house through the HUD program in March 1970 for \$20,000. The bar used by the tavern still covered a large portion of the living room, paint was inexpertly applied over rough and broken walls, and the bedroom floor was warped and buckled, rendering the home inhabitable.

In 1971, the appraiser for the HUD office in Newark, and 11 other Newark employees, were indicted for fraud. Federal investigators discovered that one-third of Section 235 houses had been overappraised. Failure to comply with HUD requirements was found in hundreds of other cases. At least 84 houses contained major defects such as sagging floors, inoperable furnaces, rotting siding, and fallen plaster. Additionally, 119 cases of deferred maintenance were revealed, covering everything from leaky faucets to peeling paint. Another 86 cases involved failure to follow through with proper licensing and inspections for plumbing, wiring, and pest control projects.

#### THE ROBIN HOOD OF HUD

During the mid-1960s, Bruce Rozet established the Commonwealth United Corporation, a Hollywood conglomerate based in Beverly Hills, California. In January 1969, Rozet began working with the Fund of Funds, a European company, headed by Bernard Cornfeld, a European investor with a shady reputa-

tion, to raise \$30 million in Eurobonds with the intention of purchasing the Rexall Drugstore chain. When those plans fell through, Rozet decided that he could rob the rich and help the poor by negotiating contracts for subsidized housing, focusing on rehabilitation projects.

The result was a housing disaster that covered the United States from the Atlantic to the Pacific. When his questionable dealings became public knowledge, Rozet established HIPPLE (Housing Partnership Investments Limits) and continued to work with government housing projects. After California government officials refused to do business with any company led by Rozet, he paid himself a \$600,000 severance fee and began working in the background. In October 1977, the Securities and Exchange Commission (SEC) targeted Rozet and charged him with defrauding investors and falsely reporting profits.

Rozet again reinvented himself and established the National Development Services Corporation (NDS), which acquired existing HUD housing projects. By 1981, Rozet had been a party to the transfer of over 150 housing projects involving over \$400 million in real estate deals. Through a number of other under-the-table and behind-the-scenes deals, Rozet managed to make a \$200,000 profit for NDS over several years.

On February 13, 1989, President George H.W. Bush appointed former congressman Jack Kemp as head of HUD. When Kemp's attention was called to Tyler House, a Rozet project in Washington, D.C., he was outraged. The general contractor sent to investigate reported to Kemp that the house looked like "Beirut after the bombing." Other reports came in from all over the country reporting problems with Rozet's projects. Rozet was forbidden to do business with HUD. On April 27, 1998, Rozet was charged with overcharging HUD, inflating costs of repairs, and taking kickbacks on 90 separate projects in 25 states, Washington, D.C., and Puerto Rico.

#### HUD AND SAMUEL R. PIERCE, JR.

During his eight years in office under Ronald Reagan and Bush, most people thought that Samuel R. Pierce was doing an excellent job as secretary of HUD. At one point, Reagan called Pierce his "most effective Cabinet member." In reality, HUD was rife with corruption, and Pierce was asleep at his post,

sometimes spending whole days watching soap operas on his office television while his staff ran the agency. Congressional committees discovered that prominent Republicans were receiving millions of dollars in contracts from HUD officials who were pocketing tens of thousands in kickbacks. Republicans identified by investigators as influence peddlers included Bush's deputy chief of staff; a dancer and a former California senator; the former head of the General Services Administration; a personnel officer in the Reagan White House; a lobbyist and a Republican campaign adviser to Bush; and John Mitchell, former President Richard Nixon's attorney general. In addition to influence peddling, the 14-month Congressional investigation uncovered widespread fraud, abuse of office, blatant favoritism, monumental waste, and gross mismanagement at HUD.

The most colorful character in the Pierce scandal at HUD turned out to be a former barmaid turned executive secretary whose political lineage was traceable to high-ranking officials on both sides of the political spectrum. Deborah Gore Dean, a cousin to former Vice President Al Gore and stepdaughter to John Dean, a Nixon White House aide of Watergate fame, worked her way up to the position of assistant to Pierce. Dean rejoiced in negotiating deals and controlling access to the powers that be. During her reign at HUD, Dean virtually ran the agency, making sure that lucrative contracts were given to particular Republican consultants. While Pierce hid in his office, Dean used an autopen to sign his name to important documents, represented Pierce on various committees, lobbied Congress for increased appropriations to HUD, and served as HUD's link with the White House.

When she appeared before Congress, Dean invoked the 5th Amendment, protection from self-incrimination, and remained silent. In April 1992, Dean was indicted and charged with making false statements to Congress, fraud, and conspiracy. She denied any wrongdoing. In November 1993, Dean was convicted on 12 of 13 criminal counts stemming from her activities at HUD. Faced with the possibility of from seven to 57 years in jail, Dean was sentenced to only 21 months in prison. Numerous appeals kept her from serving her sentence, and her conviction was later overturned.

As head of the Urban Development Action Grant program (UDAG) at HUD, Lance Wilson rewarded himself with limousine and hotel service

and tickets to Broadway shows. Individuals seeking to do business with HUD wine and dine him and gave him clothes and pocket money. During investigations into the HUD scandal, investigators also learned that Wilson had neglected to report that he held an interest in a partnership that did business with HUD, or that he was paid consulting fees by various developers who worked with HUD. Wilson stated that he had made \$100,000 while employed by HUD. After leaving HUD, Wilson continued to negotiate deals with HUD. In 1992, he was indicted on 24 counts of fraud, conspiracy, and perjury.

Over a seven-year period, investigations by independent councils documented extensive influence peddling during Pierce's tenure at HUD. The investigation cost over \$27 million and netted 16 convictions. One lasting effect of the Pierce scandal was a change in the way that federal agencies report financial dealings. In 1990, after a bitter battle in Congress, the Chief Financial Officers Act became law, mandating the appointment of chief financial officers in 23 cabinet departments and federal agencies, each assigned the responsibility of monitoring accounting systems to prevent any form of corruption. The law also created the Office of Federal Financial Management to coordinate the work of the agencies and to provide overall financial oversight to the executive branch.

#### HENRY G. CISNEROS

Another HUD scandal erupted when Henry G. Cisneros, President Bill Clinton's HUD secretary, was discovered to have lied to the Federal Bureau of Investigation (FBI) about how much money he had paid his mistress during a background check. Originally, Cisneros had told FBI agents that he paid Linda Jones, his mistress and a political fundraiser, around \$2,500 a month. Cisneros later admitted that between 1990 and 1994, he had paid Jones over \$250,000. As a result of the scandal, he was forced to resign from office.

On September 8, 1999, Cisneros pled guilty to the misdemeanor charge of lying to the FBI and agreed to pay a \$10,000 fine, ending an investigation that had lasted four years and which had cost the U.S. government over \$9 million. On the day the settlement was announced, Cisneros had been slated to stand trial on 18 felony charges in federal court. Clinton pardoned Cisneros before he left the presidency.

#### SEE ALSO

bribery; embezzlement; contractor fraud; whistleblowers; corruption.

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## human trafficking

HUMAN trafficking refers to the exploitation of people through transporting, recruiting, harboring, providing, or receiving people for a number of activities in which others benefit financially. It is a global problem and a social concern for many who are trying to thwart organized criminal activity. Human trafficking is logically considered a subset of organized crime, but it also has strong tangential relationships with white-collar crime: The same criminal elements in many parts of the world are engaged in political corruption, bribery, payoffs, and kickbacks, and drug and human trafficking.

Human trafficking involves both adults and children, males and females, and often has disastrous consequences for the victims of these activities on personal as well as governmental levels. It is an issue that is global in scope and that involves the abuse of the most basic tenets of human rights. Human trafficking vividly illustrates the results of poor economic conditions and the devaluation of oppressed people. It is estimated that approximately 900,000 people are trafficked each year globally.

and 20,000 are trafficked into the borders of the United States.

Forced labor, more commonly known as slavery, has likely been around since shortly after the dawn of humankind. This abhorrent practice continues throughout the world despite attempts and varying strategies by governments to stop it. Many adults and children are lured into positions of forced labor in the hope of a better way of life. It is widely believed that slavery no longer exists in the modern world; however, this is a fallacy. Slavery has simply changed form over time.

Slavery continues to exist. Kevin Bales, a leading expert in the area of what is known as “modern slavery,” notes the differences between the old slavery of ancient Greece, Egypt, and Rome, and even the “peculiar” institution of 19th-century American slavery, and the new type of slavery that has developed globally since World War II.

The contemporary forms of slavery have resulted primarily from population increases and social change. A typology of this new slavery is also provided by Bales: 1) chattel slavery, a remnant of the old slavery, in which people are born, captured, or sold into slavery; 2) debt bondage, sometimes called peonage and the most common form of contemporary slavery, in which people are enslaved in order to pay off debts (sometimes continuing through several generations of family servitude); 3) contract slavery, in which false or deceptive contracts are used to justify or explain forced slavery; 4) war slavery, in which people are enslaved in order to defray costs associated with military campaigns; 5) domestic servitude, in which “extra children” (children from excessively large families) are placed into domestic service, often for extended periods of time, and 6) ritual (religion-based) slavery, in which people (usually young girls) are provided as slaves, often in sexual enslavement, to atone for the sins of family members. An understanding of the new forms of slavery is important in understanding the various aspects of trafficking in humans.

## CHILD EXPLOITATION

Children are often sold or sent to areas with the promise of a better life but instead encounter various forms of exploitation. Children are often forced to work in cottage industries, manufacturing operations, the entertainment industry, or other occupations. They are frequently required to work for

excessive periods of time, under extremely hazardous working conditions, and for little or no wages. Sometimes they become “street children” and come under the influence of youth gangs, and are used for prostitution, theft related offenses, begging, or become actively involved in the drug trade. In addition, children are sometimes recruited into military service and experience armed combat situations at very young ages.

## SEX CRIMES

A very common form of human trafficking that results in servitude is the recruitment and transport of people into the international sex industry. Sex slavery involves males and females, and both adults and children. It consists of a number of different types of forced servitude including forced prostitution, pornography, child sex rings, and sex-related occupations such as nude dancing and modeling. Forced prostitution is a very old form of enslavement and recruitment into this lifestyle is often a booming business for purveyors of the sex trade.

The practice was earlier called “white slavery” to differentiate the practice from the enslavement of Africans in the United States and other countries, and received much attention around the turn of the 20th century. Victims of sexual slavery are often manipulated into believing that they are being relocated to areas in which they will benefit financially and work under favorable occupational conditions, normally not being told that they are going into sex-related occupations. They are promised legitimate forms of employment as domestic laborers, farm workers, nannies, food servers, retail sales clerks, or other licit types of occupations. Those who enter the sex industry as prostitutes are exposed to inhumane and potentially fatal conditions, especially with the advent of AIDS.

## SELLING ORGANS

Another recent and highly controversial occurrence involving human trafficking is the abduction or deception that results in the involuntary removal of bodily organs. For years there have been reports from Asia that human organs were harvested from executed prisoners without the consent of family members and transported to transplant recipients in various countries. There have also been reported incidents of the removal and transport of organs by

medical and hospital employees. In addition, there have been claims of impoverished people selling organs such as kidneys for cash or collateral. Although there have been some allegations of trafficking of human fetuses for use in the cosmetics and drug industry, these reports have not been substantiated. In recent years, the internet has been used as a medium for the donors and recipients of organ trafficking, whether legal or not.

## CAUSES

There are many possible causes of human trafficking and most involve the economic situations of the areas in which the trafficked people live. Bales describes three primary factors that reflect the new style of slavery that has developed over several decades: 1) as mentioned earlier, a dramatic increase in the world population has produced an overabundance of people for the job market; the residual people are normally those that lack power and are highly vulnerable to the abuses of slaveholders; 2) the modernization of agricultural equipment and practices has aggravated conditions for poor farm workers, adding to the vulnerability of these individuals; and 3) the changing economic and social conditions have created opportunities for exploitation not only by greedy slaveholders but also corrupt officials; anomic conditions reflect the breakdown of cultural bonds that are no longer able to protect those vulnerable to contemporary slavery.

The U.S. Department of State adds that the HIV/AIDS epidemic is creating a large number of orphans and child-headed households, a situation that creates fertile soil for trafficking and servitude. The agency also provides insight into some potentially disastrous effects to the world, including: 1) a deprivation of a normal life and basic human dignity; 2) a breakdown in normative structures and the resulting increase in other forms of criminal activity; 3) a negative impact on the labor markets and social conditions; 4) an increased exposure of people to abuse and HIV/AIDS; 5) an undermining of local governmental agencies; and 6) an increase in organized criminal activities and activities involving corruption among law enforcement officials.

Many governmental entities throughout the world and in individual nations attempt to stop or at least slow the activity of trafficking in humans. In 2000, the United Nations established the Protocol to Prevent, Suppress and Punish Trafficking in Per-

sons, Especially Women and Children, Supplementing the United Nations Convention Against Transnational Organized Crime, which provided a commonly accepted working definition of human trafficking, and which called upon national governments to promulgate laws to combat the practice, to provide assistance for victims, and to promote coordination and cooperation between countries.

The Office of Drugs and Crime is the arm of the United Nations that has the responsibility of monitoring and implementing policies concerning human trafficking and is the designer of the Global Program Against Trafficking in Human Beings (GPAT). Another important international agency with responsibility in this area is Interpol, the international policing agency, whose aims are to provide assistance to all national criminal justice agencies, raise awareness of the issue, and promote competence among agencies.

Other involved global organizations include the International Labor Organization (ILO) and the International Organization for Migration (IOM), as well as a host of other governmental and non-governmental entities. In the United States, many federal agencies are given the oversight of human trafficking, including the Department of Justice, Department of Homeland Security, Department of Health and Human Services, Department of Labor, and the U.S. Agency for International Development. The primary U.S. agency charged with monitoring human trafficking is the State Department's Office to Monitor and Combat Trafficking in Persons (also called the trafficking office).

The incidence of trafficking in persons and the accompanying forced servitude, often called the new slavery, is gaining increasing notice from the world community. In 2000, the United Nations put the subject in the international spotlight and called for changes in state policy for what the International Labor Organization has termed "the underside of globalization."

## SEE ALSO

Africa; Arab nations; Asia; South America; prostitution; organized crime; globalization; labor crimes.

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## Hyde, Edward (1661–1723)

EDWARD HYDE (Lord Cornbury), a cousin to Queen Anne of England, was widely considered to be the black sheep of the royal family. Nevertheless, his prominent connections enabled him to be appointed governor of the New York colony, and he held that position from 1702 to 1708. Governor Hyde quickly confirmed his scurrilous reputation. Indeed, he probably did more than any other royal governor to bring British administration in America into disrepute.

In the simplest of terms, Hyde was a drunkard and an unabashed transvestite, with a penchant for addressing the New York Assembly while wearing

his wife's clothes. He was also a crook, as thoroughly dishonest in his public role as he was outlandish in his private life. He illegally allotted huge land grants, ranging in size from 50,000 to 1 million acres or more in exchange for kickbacks and bribes.

In 1707, Hyde claimed to have received secret information that the French were preparing to invade New York by sea. He taxed the citizenry 1,500 pounds, ostensibly for the construction of protective batteries around the harbor. The French invasion was a fabrication; Hyde used the funds to build a lavish new mansion for himself on a tract of land he immodestly renamed Hyde Park. Ironically, the property would later house become the family estate of the Roosevelts. Governor Hyde's thievery so outraged the Assembly that he was removed from office and briefly imprisoned.

Some historians and other social scientists consider this the first major political corruption scandal in American history.

### SEE ALSO

United States; United Kingdom; corruption.

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# I

## IBM

ONCE FAMOUS FOR ITS one-word motto, “Think,” this high-technology colossus pursued ideas that included secret files and collaboration with foreign governments. In 1996, IBM was rumored to have sold two shipments of high performance computers to Russian nuclear research facilities, one in the closed city of Arzamas-16 and the other in an unknown location. A Congressional investigation noted that the United States would benefit from assuring Russia’s cooperation with the Comprehensive Test Ban Treaty (CTBT) by allowing it to maintain its existing nuclear stockpile through computer simulations. The problem with IBM’s activities was that the company had applied for the necessary federal license to ship the computers; when the government requested more information on how the computers would be used, IBM short-circuited the process by shipping the computers through its German subsidiary to a Moscow computer dealer, Jet Infosystems.

Russian diplomats argued that the United States had promised similar computers as an incentive to agree to the CTBT. Private industry pursued the business. “IBM was very pushy. They thought Arzamas could be like Los Alamos, a very prestigious customer,” Yevgeny Shablygin, head of Jet Infosystems, told the *New York Times*. Russia refused

to cooperate in the federal prosecution of IBM. The case was settled in 1998, with IBM paying an \$8.5 million fine. The U.S. Department of Energy quietly contributed \$2.3 million to a project with the Russian Ministry of Atomic Energy, resulting in the 16 illicit computers being featured in an “open computer center” dedicated to nonweapons research, in Arzamas-16, now returned to its former name of Sarov. The center opened in September 1999.

Using European subsidiaries to evade U.S. laws was not new to IBM. In a controversial 2001 book, Holocaust expert Edwin Black argued that the keystone of IBM’s business strategy in 1930s Europe was supplying equipment and expertise to the Nazi program of identifying and exterminating Jews. Identifying Jews for deportation to concentration camps required a massive census effort. IBM not only actively pursued the business of providing customized Hollerith machines and punch cards—an early form of computer technology—but also provided technical support to Nazi governments throughout World War II.

When numerous U.S.-based companies were blacklisted for trading with the enemy in 1942, IBM’s subsidiaries were not included. However, a separate 1943 investigation established that IBM’s New York headquarters had approved the company’s activities in Germany as part of an effort to establish a cartel controlling the world’s supply of

computer punch cards. Black notes that, since the U.S. government saw the Hollerith machines in Europe as critical to the success of its military occupation, IBM was never penalized. The company reabsorbed its German subsidiary and its profits; other European subsidiaries had always reported directly to American headquarters. A 2001 class action suit by Holocaust survivors against IBM was swiftly dropped due to concerns that it would slow long-awaited German plans for restitution to survivors.

Charges of monopolistic practices resurfaced in the late 1960s, when IBM was barraged with lawsuits from computer industry competitors. The company's practice of bundling equipment, peripherals, programs, and support under a single price was seen by smaller manufacturers as a tactic to keep rivals out of each separate market. While most suits did little damage to IBM, peripherals manufacturer Telex scored a temporary victory in 1973, when a judge ruled that IBM's SMASH initiative to gain market share through lowered prices was an antitrust violation worth \$350 million in damages. Historian Robert Sobel argues that before the verdict was reversed on appeal, suing IBM became a key business strategy for smaller competitors simply as a means of demonstrating commitment to growth.

### ANTITRUST CHARGES

The U.S. Department of Justice also pursued antitrust charges against IBM starting in 1969, but the case stalled on the absence of a vast computerized document index, developed for a 1968 antitrust action initiated by Control Data Corporation (CDC), that was rumored to prove IBM's monopolistic practices beyond doubt. However, IBM's settlement with CDC required CDC to destroy the index in the presence of IBM's attorneys. This was done despite Justice Department efforts to prevent it. The federal charges were dropped in 1982.

Secret databases would also become critical to a lawsuit filed by former IBM workers, who allege that the company knew, from its 30-year file of employee death records, that employees faced excess cancer risks due to exposure to toxic chemicals. As of September 2003, IBM was seeking to exclude analysis of the files from upcoming hearings in Santa Clara, California, arguing that the information was incomplete.

### SEE ALSO

World War II; antitrust; United States; Germany; Justice, Department of.

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## identity theft

**IDENTITY THEFT** or fraud is the wrongful obtaining and use of someone else's personal data in some way that involves fraud or deception, typically for economic gain. Many people become victims of identity theft each year, although there are no accurate statistics that can put an exact dollar amount on the cost that Americans suffer financially and emotionally each year. Monetary loss is just one side of identity theft. Victims suffer long-term physical and emotional strain as they seek to restore normalcy to their lives and their credit. According to a report issued in March 2002 by the U.S. General Accounting Office, identity theft is one of the fastest-growing crimes in the United States and the world today. Recent statistics show that approximately 700,000 individuals are victimized each year.

Unfortunately, identity theft can happen in many ways and with relative ease. Dumpster diving, mail theft, inside sources, impersonation, online data, direct access, and stolen purses and wallets are the most common ways an identity is stolen.



Dumpster diving consists of thieves rummaging through trashcans searching for personal identification (receipts, bank statements) that can be used to steal an identity. A crosscut shredder may be the best investment any individual can make to prevent this form of identity theft.

Fraudsters steal mail from mailboxes that have been conveniently flagged as holding mail. At the end and beginning of each month, thousands of people pay their bills, place them in their mailboxes, and put the red flag up to alert postal workers that mail is ready for pickup. Unfortunately, this red flag also tells the would-be criminal that mail is ready for stealing. Credit card bills contain encoded credit card and personal identification on the bill, and banking information is located on the check set for payment.

A dishonest employee with access to personal records, payroll information, insurance files, and account numbers and sales records can wreak havoc on others' credit and facilitate identity theft. In New York City in 2002, three individuals were indicted for allegedly stealing the identities of more than 30,000 people, stealing at least \$2.7 million. This scheme was spearheaded by a junior employee of a company that worked for the major credit reporting agencies and had access to credit histories. The circumstances that enabled this incident to occur could easily be repeated if credit data is not safeguarded.

Internet or online data has become common. Thieves can access data that consumers share through phone listings, directories, memberships, etc. Thieves can also purchase sensitive personal information from an online broker. Social security numbers, birthdates, and other personal information should never be shared over the internet unless one knows for certain that the site is legitimate and protected with encryption software.

Stolen purses and wallets are easy ways to assume someone's identity. Bank cards and personal information can also be stolen directly from one's house by people such as babysitters, friends, roommates, and cleaning personnel.

There is no foolproof way to prevent crime, but experts advise consumers can decrease the chances of becoming an identity theft victim. Guard personal information, never give out Social Security numbers to anyone unless there is a good reason for needing it. Destroy sensitive papers, like receipts, credit card applications. Invest in a paper shredder,



*A lost wallet in the wrong hands can mean years of efforts to recover from identity theft and to clean a credit record.*

be suspicious of telephone solicitors, use a locked mailbox, and check credit reports once a year from the three major credit reporting agencies.

Identity theft is a crime that hurts its victims not just once but twice. First, since most people do not check their credit reports on a regular basis, they discover that they are a victim by getting turned down for a loan for a car or house. Second, once a person does figure out that her identity has been stolen, she needs to go through a remarkably arduous process to repair the credit. In many instances, it takes years for the credit agencies to investigate the fraudulent activity; in the meantime, the car loan or mortgage will be delayed or denied.

The new 21st century and its database technologies of consumer profiles offer fresh opportunities for fraudsters. One of the biggest problems with cases of identity theft is that it can take months, or even years, before the victim is aware of any wrongdoing.

#### SEE ALSO

credit-card fraud; internet fraud; Federal Trade Commission; scams; impersonation.

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## illegal competition

ILLEGAL COMPETITION refers to particular business practices or strategies banned by legal statutes. Ideally, legislation bans types of competition that either inhibit economic efficiency or are inherently unethical. There is a strong association between competition and economic efficiency. In contrast, monopolistic prices reduce economic efficiency by reducing the total amount traded in monopolized markets. These unrealized gains from trade represent a misallocation of scarce resources. Also, there is a transfer of income for those who buy monopolized goods at higher prices. The monopolist gains rent, the difference between the monopoly and competitive prices multiplied by the number of remaining sales. Consumers lose this income. The costs of affecting these transfers represent additional waste.

Consumers generally benefit from competition between businesses because it leads to lower prices and higher quality. To expand, or even retain, market share in a competitive environment, businesses must offer the highest quality and lowest prices that they can manage. There are, however, some business strategies that some argue reduce overall economic efficiency. Predatory pricing is a strategy whereby a business sells its product below cost. The immediate effects of this pricing strategy are beneficial to consumers. However, the long run affect of predatory pricing is to drive out rival firms. Leaving the predatory firm with a monopoly. As a monopolist it would then want to raise its prices above competitive levels.

### STANDARD OIL

Perhaps the single most important case concerning predatory pricing was *Standard Oil Company of New Jersey v. United States*. In the late 19th century, Standard Oil attained 90 percent market share in American oil refining. The Supreme Court found Standard Oil in violation of the Sherman Antitrust Act, specifying predatory practices on the part of Standard Oil. Critics of this and other similar rulings have argued that the evidence actually reveals the rarity and ineffectiveness of predatory pricing.

Often, the refineries that Standard shut down with a price war simply reopened after Standard increased its prices. In the absence of barriers to entry

in the market in question, it is not clear that a predatory pricing strategy will work. This strategy requires large financial resources on the part of the predatory firm, along with the willingness to risk them in such predatory ventures. Doubts concerning the profitability of this strategy have left many economists skeptical concerning the need for legal rules against predation.

There were other allegations against Standard. Some claimed that Standard committed industrial espionage and sabotage. While nobody proved the worst accusations against Standard, some businesses do commit serious crimes in attempts to gain market share. Such practices clearly involve illegal acts. Businesses attempt to steal information on their rival's research and development. Increased market share through such practices provide no benefits to consumers.

### DUMPING AND TYING

Corporate dumping is a variation on the predatory theme. Dumping usually refers to foreign competitors who sell their products below production costs in order to subdue domestic producers. Foreign firms may sell at lower prices abroad than at home. Profits in their domestic markets go to subsidize short-run losses abroad. After gaining monopolies abroad, these foreign firms can begin reaping monopoly profits.

One example of alleged dumping concerns the export of apple juice from China to the United States. U.S. firms claimed that they lost \$135 million due to Chinese dumping juice in American markets at prices below production costs. Another example is provided by Smith Corona when it accused Brother Industries of Japan of dumping portable typewriters. Also, U.S. steel industry representatives claim that Russia, Japan, and Brazil have dumped quality steel products.

While there are obvious jurisdictional limits to U.S. antitrust laws, public officials can deal with such practices by imposing anti-dumping duties on foreign firms that sell at less than fair market value. The imposition of these duties on companies that supposedly engage in dumping sets limits, in theory, on the ability of exporting businesses to compete in this manner. In practice, the existence of legitimate cases of successful dumping is questionable, and efforts to limit cheap imports have often met with little success.

Tying is a practice whereby a business requires its customers to buy two products together. If a business has a monopoly on the supply of one product, it can extend its monopoly leverage to other products through tying. Section One of the Sherman Act and Section Three of the Clayton Act prohibit this practice when it “restrains trade substantially” and “may tend to create a monopoly.”

The Justice Department case against Microsoft concerned tying and the laws against it. Microsoft required computer manufacturers to use their internet browser along with their Windows operating system. Microsoft supplied their browser at no additional cost. Yet, Judge Thomas Jackson ordered Microsoft to provide its operating system and browser separately.

#### FRAUD

False advertising and fraud are also forms of illegal competition. Businesses that gain market share by misrepresenting their own or their competitors' products are subject to legal penalties. One famous case of alleged fraud was filed against Preston Tucker and his Tucker Corporation in the late 1940s. Prosecutors in this case needed to prove that the car Tucker claimed to be developing either could not be built or would not live up to expectations. Tucker and his associates were cleared of these charges in 1950. While not every case of fraud stands on its merits, legitimate cases do exist and require judicial action. False advertising and fraud obviously run counter to the notion of moving resources to their most highly valued uses. The notion that fraud reduces economic efficiency is therefore hardly controversial.

While the examples of espionage, fraud, and sabotage are clearly undesirable, Antitrust laws concerning pricing strategies are more controversial. There are reasons to believe that antitrust laws are unnecessary, or perhaps even counterproductive. This viewpoint says businesses faced with declining market share might lobby the government for antitrust cases against their more successful competitors. Businesses that gain market share for legitimate reasons may then face unwarranted legal action. These costs are not inconsequential.

The lawsuits enacted by the Justice Department and by private businesses often involve cases where businesses have expanded output and lowered prices. Also, statistical studies indicate that abnormally high rates of profit are either transitory or

due to superior efficiency. At least part of the reason for antitrust laws is to enable businesses that are less able to serve their customers to persist. Resource expenditures on lawsuits for this purpose lead to transfers to such firms. This “rent seeking” behavior reduces economic efficiency and can, in the extreme, lower living standards.

Some forms of competition reduce economic efficiency and breach ethical barriers. Other forms of competition are either harmless or beneficial, and may be wrongly prohibited. It is undeniable that the profit motive drives private businesses, rather than the general welfare of society or ethical considerations. This makes the definition and enforcement of laws that target harmful competition both necessary and problematic. It is necessary to restrain the pursuit of profits where it leads to the monopolistic misallocation of resources, but equally necessary to insure that business laws do not facilitate such misallocation instead.

#### SEE ALSO

advertising fraud; antitrust; Clayton Antitrust Act; corporate dumping; Standard Oil.

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## Imperial Food Products

ON SEPTEMBER 3, 1991, 25 workers at the Imperial Food Products chicken processing plant in Hamlet, North Carolina were killed in an explosion and fire. A rupture of a hydraulic line near a deep

fryer caused the explosion. However, through the investigation of the explosion, it was determined that the employees died because the fire doors were locked and they were unable to escape. All but one of the deaths were caused by smoke inhalation, which would have been prevented if the employees were able to escape. Many of the employees escaped the smoke by retreating to a large freezer, but they were unable to fully close it to keep out the toxic smoke and subsequently died. The employees had time to reach the freezer, so they most likely would have had time to escape if the fire doors had not been locked and there were adequate and well-known ways to safety. This evidence led to criminal charges levied against the plant owner and manager.

This unfortunate disaster has been labeled as a state and corporate crime because of the failure of not only the plant owner and manager but because of a long history of failure to inspect the plant by various state and federal agencies. The Occupational Health and Safety Administration (OSHA) is the main federal regulatory agency charged with the health and safety of workplaces for employees in the United States. OSHA was created in 1970 from the Occupational Safety Health Act. The act's stated goal is to ensure that every working person and woman in the United States has safe and healthful working conditions. The law has given employees a wide range of rights. One of these rights requires companies to reduce risks in the workplace, and if there are risks, then employees have the right to fight for health and safety.

During the 1980s, OSHA's budget was drastically cut and this had a major impact on the ability for OSHA agents to conduct inspections. Inspections are the main tool used to make sure that companies comply with safety standards that are set for each industry. In 2003, OSHA had 1,123 inspectors charged with overseeing approximately 7 million worksites that employ over 111 million workers. OSHA had 1,388 inspectors in 1980. The United States has seen an increase in worksites and employees but a decrease in the number of inspectors. Because OSHA is so strapped for inspectors, it allows many of the states to take over this responsibility. Section 18 of the Occupational Safety and Health Act of 1970 encourages states to develop and operate their own job safety and health programs. OSHA approves and monitors state plans.

North Carolina, where Imperial Food Products was located, is one of the 23 states that have a state-

run OSHA program. Many of these 23 states have only conditional approval though, because they may not comply with federal OSHA regulations. At the time of the Imperial explosion, North Carolina was not in compliance and they were on probation.

Each state that has its own OSHA operation is permitted to set its own penalties and priorities. North Carolina has historically minimized the effect of penalties for health and safety violations. For example, many of the maximum fines in North Carolina are a fraction of the federal fine maximums. The plant had never had a single safety inspection during its 11 years of operation, which shows the complete failure of the North Carolina OSHA inspectors.

All work sites must post the phone number of OSHA or the state equivalent so that employees know who to contact to report safety violations. At the Imperial Food Products plant, the poster listed a number that was disconnected with no forwarding one. This simple and basic requirement was not even being met, let alone the dozen other safety violations that were occurring at the plant, including the lack of fire alarms and sprinkler system, in addition to the blocked and locked doors. By law, in the case of fire codes, exits are to be clearly marked and known to the employees. Federal OSHA law is even stronger in language it that it states that every exit must be well lit, door passages and stairways need to be clearly marked and all doors must be unobstructed.

In September 1992, the owner of Imperial Food Products, Emmett Roe, age 65, pleaded guilty to involuntary manslaughter as part of a plea bargain. His son Brad was let off scot-free as part of the plea bargain. Emmett was sentenced to 20 years in prison for his responsibility in the deaths of 25 of his workers. The case remains one of the severest punishments for a worker-safety violation.

#### SEE ALSO

Occupational Safety and Health Act; workplace deaths; sentencing guidelines.

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## impersonation

Assuming the identity of another person, real or unreal, deceased or living, or pretending to possess characteristics that do not accurately reflect one’s true attributes or background are characteristics of impersonation. The individuals who practice this activity are commonly known as impersonators; however, if the impersonation involves fraud and deception, other more negative terms are used, such as impostors, charlatans, or mountebanks. Criminal forms of impersonation are often referred to as false personation and offenders are subject to varying forms and degrees of sanction.

Throughout history, there have been numerous cases of people who have used false personation in a variety of different ways and many have become quite famous for their activities. Many of these identity thieves have been the inspiration for books, articles, television specials, documentaries, plays, and movies and have achieved a significant degree of notoriety during the periods of time in which they lived (and still live).

George Psalmanazar was one of the early imposters to become famous as a result of false affirmation. In the very early 1700s, Psalmanazar claimed to be a native of Formosa (modern day Taiwan) and became somewhat of a curiosity in Europe as he passed himself as an expert in Formosan culture. His book, *An Historical and Geographical Description of Formosa*, was published in 1704 and Psalmanazar was given an academic appointment at Oxford College as a linguistic translator and lecturer in Formosan civilization.

However, people began to wonder why this person of reportedly Asian descent was blond and light-skinned. Jesuit missionaries who had been to Formosa were especially vocal in refuting his claims. The impostor continued the hoax until 1706, when he admitted to misleading the public. Although little is known of his actual identity, it is believed that Psalmanazar (which was not his original name) was

a French wanderer. He continued to write and publish until his death. The memoirs of his imposture were published posthumously.

## ANASTASIA

Another famous case of impersonation was Anna Anderson, who claimed to be Grand Duchess Anastasia Nicholaevna, daughter of Tsar Nicholas II of Russia. In 1918, the imperial family was murdered and their bodies were buried in hidden graves. Two years later, a woman going by the name Anna Anderson came to public attention after attempting to jump from a bridge in Germany. She was placed in a mental institution and later claimed to be the grand duchess.

There were many similarities between the two, and Anderson seemed to have an unusual level of knowledge about the imperial family. Anderson filed suit in Germany to prove her claims and to accept her rightful inheritance. The legal proceedings lasted from 1938 to 1970 and though some experts claimed that she was, in fact, the Tsar’s daughter, the court did not find in her favor.

After marrying a wealthy American and moving to the United States, Anderson died in 1984, never having received support for her claims. DNA analysis conducted years later confirmed that Anderson was not Anastasia. Despite scientific evidence to the contrary, many people still believe that she was truly the duchess. The story has generated books, articles, television documentaries, three movies, and continuing controversy over Anna’s actual identity.

Some cases of impersonation involved “passing” as a person of another racial or ethnic group, or of the other gender. In particular, it seems that impersonating Native Americans was a popular endeavor for several people. Although there have been many “faux Indians,” three gained the most fame in their respective time periods. Chief Buffalo Child Long Lance, despite many inconsistencies in his claims, passed as one of the most famous American Indians in American and Canada until his death by suicide in 1932; he achieved fame and wealth (including movie roles) despite the fact that he was actually an African-American from North Carolina.

Even more famous than Chief Buffalo Child Long Lance was Grey Owl, a Canadian conservationist and outdoor guide, who assimilated with the Ojibwa and, in the early part of the 20th century, became a famous author and the subject of the

movie *Grey Owl*, released in 1999; this imposter was actually from England.

Iron Eyes Cody was at one time America's most recognizable American Indian movie actor and activist, best known as the "crying Indian" portrayed in the Keep American Beautiful campaign television commercials in the early 1970s; it was later determined that Iron Eyes was actually an Italian-American from Louisiana, though he vehemently denied the claim. Although each of these individuals used deception in passing themselves as American Indians, it should be noted that they all made contributions to the plight of their adopted group.

### FANTASTIC IMPERSONATORS

There are numerous examples of literary authors who write under assumed names, but some have seemed to actually accept new identities. Patrick O'Brian is a notable example of this situation. O'Brian was the author of several literary classes of sea-related adventures, including the novel *Master and Commander*, which was released as a movie in 2003. O'Brian claimed to be Irish Catholic and educated by a governess, however it was later found that he was actually Richard Patrick Russ, who was born and reared in Britain by Jewish parents, and educated in a less than prestigious boarding school.

Perhaps the most famous imposters in the music world are the two members of the pop band Milli Vanilli. This band, consisting of European singers Fab Morvan and Rob Pilatus, released an album that earned a Grammy for Best New Artists in 1989. It was later learned that other artists actually sang the songs on the CD and the two imposters lip-synched the words when performing. The faux band's producer admitted the hoax and Milli Vanilli was forced to relinquish their Grammy. Subsequent attempts to release "real" albums failed and Pilatus later died of a drug overdose.

Some impersonators became so famous that they had movies based on their deceptive exploits. David Hampton found that claiming to be the son of famous actor and singer Sidney Poitier allowed him to swindle several high profile people out of their money; Hampton became the inspiration for the play, and later movie, *Six Degrees of Separation*. Another well-known deceiver was Ferdinand Waldo Demara, Jr., who passed as a number of assumed identities such as physician, zoologist, law

student, researcher, orderly, deputy, and teacher, apparently simply for the pleasure of getting away with it; the popular book and movie *The Great Imposter* was based on his life. The most famous identity con man, however, is probably Frank Abagnale, Jr., who posed so successfully as an airline pilot, attorney, professor, and physician that, after serving years in prison for his deceptive activities, he became an investigator of fraud; he was the subject of the book and movie *Catch Me if You Can*.

The individuals listed above exemplify the most famous cases of identity deception. The motives of these people are different: some wanted wealth, others wanted fame, and others seemed to get enjoyment from the activity itself. Perhaps all of the offenders wanted elements of all three, to varying degrees. The issue of "passing" as someone else is intriguing from a social psychological perspective. According to some authors, imposters are simply part of the national zeitgeist and the reason that society disapproves of these "identity chameleons" is that they disrupt expectations of safety and our collective notion of reality. It was the zeitgeist, or "spirit of the times" that is sometimes used to explain the reactions of one of the greatest hoaxes in American history; on Halloween in 1938, Orson Welles, posing as an imminent scientist, described the landing of Martian space ships as part of a radio broadcast which set off an episode of mass hysteria throughout the nation. Perhaps the new zeitgeist is one of a more technical nature and there growing concern over the issue of identity theft. Identity thieves obtain personal information from victims then use this information for personal, normally financial, gain. Following the patterns of history, it is likely to assume that new imposters will become famous over their exploits and will be the subject of books, television specials, and movies. In this manner, they will be simply impersonating the "identity thieves" who came before them.

### SEE ALSO

identity theft; credit card fraud; internet fraud; forgery.

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## Indonesia

THE UNITED STATES provided arms aid to the Republic of Indonesia in a 1958 military coup that overthrew the Indonesian Communist Party (the PKI), a class-based democratic socialist movement. The PKI had come to power through a social force organized by poor citizens attempting to establish a new democracy.

The United States provided this aid to ensure that private U.S. industry would be able to exploit the oil resources of the area, and thus increase the size of the corporate oil market. The actions of the U.S. government on behalf of American corporations in Indonesia stand out, with actions in Chile and Colombia, as examples of international corporate crime.

The island of East Timor became victimized in this economic struggle for Western control of the oil. East Timor is an island located about 300 miles north of Australia and east of the Indonesia. During the colonial era, Indonesia and Timor were both occupied by Western European powers. Between the Timor Islands and Australia lies one of the world's richest oil reserves, containing as much as 5 or 6 billion barrels; thus, since the 1950s, the United States and other Western powers have attempted to wield an influence in this area.

As America began supporting the Indonesian military, Major General Suharto (sometimes spelled Suharto), the military leader, began the extermination of the PKI membership. The U.S. government often opposed class-based democratic movements on the grounds that they might interfere with the free market or multinational corporate growth. The U.S. government did so in Chile in the late 1960s and has tried to do so for years in Colombia. Suharto took over Indonesia with the help of U.S. aid in 1965, along with the assistance of other West-

ern powers. Over one-half million Indonesians, mostly poor landless peasants, were murdered over the course of just a few months. Over the next four decades, the United States trained Indonesian military forces, many of whom were also responsible for the murders of East Timorese when Suharto invaded the region in 1975.

The Indonesian government then began a 30-year project of accumulating foreign debt and Westernizing the country, with 30 percent of the World Bank loans ending up in Suharto's pockets. During the Suharto dictatorship, transnational corporations invested millions of dollars, mostly in oil extraction. The first transnational corporation to set foot in Indonesia was Freeport McMoran Copper and Gold, an American company that immediately began exploiting oil, timber, and mineral resources in a virgin forest.

Prior to Suharto's regime, Indonesia consisted of more than 30,000 different languages, over 20 ethnic groups, and a variety of religions including at least four separate Muslim groups, Chinese Buddhists, Chinese Hindus, Chinese Confucians and Christians. An elite ethnic minority called the Javanese, made up of many of Suharto's relatives, ran the nation while most of the population sank into poverty. Moreover, Chinese and Christian minorities faced widespread discrimination under this regime. The Chinese—who the early Christian colonialists had employed as tax collectors—were not permitted to use their language or worship Confucianism. They were forced to change their surnames and carry ethnic identity cards. They were also refused entry into politics and the military.

Beginning in 1974, after a revolution brought an end to Portugal's longtime colonial rule, East Timor began its movement toward independence from Indonesia. While only a minority of the movement's members wanted to remain a part of Indonesia—apparently because of the wealthy oil reserves—a majority wanted to establish an independent socialist government. In 1975, the Republic of Indonesia convinced Western powers that this socialist movement posed a communist threat to the region, and thus received Western support in its invasion of East Timor.

During the 24 years of Indonesian occupation, over 200,000 East Timorese were murdered in a genocidal campaign aimed at eliminating economic competition and civil resistance to Indonesian control. Although the United Nations Security Coun-

cil condemned the occupation, the United States and many other Western powers, including Britain and Australia, supported the occupation. U.S. policymakers provided military support by training Indonesian soldiers through funds from the International Military Education and Training Program until Congress finally banned the program in 1992. However, in 1995, a new program initiated by the Pentagon reinstated the military training regardless of the Congressional ban. Successive U.S. administrations continued to provide military arms to Indonesia for the ongoing extermination of the East Timorese. With U.S. military support, Suharto intimidated, criminalized, and murdered all opposition to his regime, and suppressed all labor movements and expressions of religious or ethnic differences. At the same time, the World Bank and Western nations including Australia, the United States, and Great Britain loaned billions of dollars to Indonesia.

#### SOVEREIGN NATION

Finally in 1999, the UN Security Council established a multinational peacekeeping force led by Australia designed to restore peace and security and to support the UN mission in establishing East Timor as a self-governing sovereign nation. However, one-third to one-half of the East Timorese population had already been murdered. In addition, Australia's late motives for involvement seemed not to revolve around humanitarian concerns but instead around oil reserves, evidenced by its earlier agreement with Indonesia to annex the oil-rich part of Timor.

The Security Council voted to prosecute the perpetrators of these crimes against humanity, and the Human Rights Commission established an International Commission of Enquiry. The commission was assigned the collection of evidence of human rights violations, but only those occurring after the January 1999 announcement of a forthcoming vote for independence. Finally, on May 20, 2002, East Timor was granted independence by the United Nations and renamed *Lorosae*, meaning Timor of the Rising Sun, thus becoming the first new nation-state of the 21st century.

West Timor was not so fortunate. As of 2000, over 100,000 East Timorese refugees remain under Indonesian militia control in West Timor, where violence against men and sexual violence against

women continues today. This genocidal episode used U.S. military aid provided to the Indonesian government as well as the Western corporate exploitation of Indonesia's resources. Moreover, additional murders occurred largely as the result of U.S. and Western inaction.

#### SEE ALSO

globalization; United States; United Kingdom.

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## industrial espionage

INDUSTRIAL espionage is closely related to economic espionage. According to the Federal Bureau of Investigation (FBI), the only distinction between the two forms of espionage concerns territorial issues. Whereas economic espionage refers to the stealing of trade secrets or confidential information by foreign governments against U.S. businesses, industrial espionage includes the theft of trade secrets by foreign or domestic companies against other businesses. In general, industrial espionage involves the secretive theft of corporate trade secrets or any information of potential value including formulas, patents, new technology developments, and other intellectual properties. The loss of these trade secrets costs companies billions of dollars each year.

The majority of industrial espionage offenders include the company's current or former employees. Nearly 85 percent of all industrial espionage incidents are attributed to employees. The use of computers and other technology systems including the internet has provided employees with relatively easy access to sensitive information and equipment including the company's research-and-development strategies, manufacturing and marketing plans, and customer lists. Attitudes toward the company play a crucial role in determining how well secrets are



kept. When employees become dissatisfied they are more likely to steal trade secrets. Also, former employees who had access to valuable information become lasting threats to the company's assets. For example, former employees can use confidential information to begin their own company.

## CASE STUDIES

Two former vice presidents of DoubleClick, an online advertising agency, attempted to establish a competing firm using secrets from DoubleClick including their revenue, pricing, and customer information. A retired Kodak employee established a consulting business and began recruiting his former colleagues to gather proprietary information about the 401 Machine, a device that makes the chemical compound, acetate, which is used for making photographic film. The retired employee sold these valuable confidential documents to Kodak's foreign rivals for thousands of dollars. In some instances, companies hire former employees of their competitors to obtain trade secrets. Bayer's Agfa group charged General Electric with improperly hiring a key official familiar with the company's new Picture Archiving and Communications Systems (PACs). Agfa alleged that after they declined to enter a joint venture with GE to work on the PACs project, GE aggressively pursued and hired Vishal Wanchoo, the vice president in charge of Agfa's PACs. Agfa charged that Wanchoo helped GE develop its electronic medical imaging business at the expense of Agfa's resources.

In a similar case, General Motors (GM) filed industrial espionage charges against Volkswagen after the company hired a top GM executive. Beyond hiring important former employees, nearly every major U.S. company has developed competitive intelligence teams to gather trade-secret information from competitors. These teams attend conferences and seminars as well as go to airport terminals in order to target competitor's salespeople and executives who can unknowingly reveal potentially damaging information about their companies. Other tactics of these intelligence units include targeting disgruntled employees to learn confidential information, reviewing criminal and regulatory filings, and engaging in "dumpster dives" to obtain discarded old documents of potential value.

The increased occurrence, cost, and threat of industrial espionage effectively lead to the passage

of the Economic Espionage Act of 1996 (EEA) which made the theft of trade secrets a federal offense. Under the EEA, trade secrets are broadly defined to include "all forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing." The EEA also stipulates that the owners must take "reasonable measures" to keep confidential information a secret. If owners fail to safeguard proprietary information, no one can be rightfully accused of stealing it. Finally, the Act requires that the trade secrets must have some form of actual or potential economic value.

## ECONOMIC ESPIONAGE ACT (EEA)

The EEA is a combination of sections 1831 through 1839 of the U.S. Codes. The Domestic Trade Secret Theft statute, or Section 1832, states that anyone who knowingly converts or conspires to convert an unauthorized trade secret into economic benefit of anyone other than the owner is in violation of the act. This section focuses only on incidents that involve domestic espionage. Both individuals and corporations are subject to sanctions. Individuals in violation of Section 1832 are eligible to a 10-year prison term and/or a \$250,000 fine and organizations can be fined up to \$5 million.

The first prosecution under the EEA occurred on day after the act took effect. In *United States v. Worthing*, two brothers, Patrick and Daniel Worthing, were indicted for stealing confidential trade secrets from Pittsburgh Plate Glass and attempting to sell the information to Owens-Corning, a competitor of the Pittsburgh company. Almost immediately after stealing trade secrets pertaining to fiberglass formulas and blueprints, Patrick Worthing contacted the head of Owens-Corning and offered to sell the privileged information for \$1,000.

Prosecutions under the EEA have been relatively rare. As of 2003, only 37 cases have been successfully prosecuted under the act. One of the primary problems is the reluctance of companies to file criminal charges. Most companies fear the risk of publicly disclosing valuable trade secret informa-

tion through court evidence documents. In an espionage case involving Bristol-Meyers Squibb and their secret formulas for the cancer-fighting drug, Taxol, federal judges ruled that prosecutors had to release the confidential documents to the defendants' lawyers in order to protect due process rights. The defendant, Yuen Foong Paper Co, a Taiwanese company, had two employees approach an FBI agent posed as a Bristol-Meyers technology information broker, and allegedly offered him \$200,000 plus a percentage of their sales for access to Taxol technology. Bristol-Meyers appealed the ruling in an effort to protect the secrets from those accused of attempting to steal them. In this way, the EEA presents problems for the both victims and the accused. Many companies have turned to private consulting or intelligence agencies to help prevent future incidents of espionage.

#### SEE ALSO

economic espionage; copyright infringement; trademark infringement.

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## Industrial Revolution

THE INDUSTRIAL REVOLUTION of the late 18th and early 19th century marked the most profound transformation of human culture since the

agricultural revolution that had changed human society from nomadic hunting and gathering to settled agricultural communities. All aspects of human life changed during the Industrial Revolution. It transformed the economic system of production from hand tools, and handmade items to machine-manufactured and mass-produced goods, moving Europe from an agricultural and rural economy to a capitalist and urban economy, and from a household family-based economy to an industrial economy. It changed human labor, consumption, family and social structure, and even the emotional and intellectual functioning of the individual person. The abandonment of the family economy was the most dramatic change that Europe had ever seen and the world is still struggling with these changes in the 21st century.

The Industrial Revolution also marks the introduction of the "white-collar" in white-collar crime, as class delineations of professionals (white collars) and workers (blue collars) became more distinct in the industrialization of the country.

#### RISE OF TECHNOLOGY

Technological revolutions have punctuated history. In Europe during the 12th and 13th centuries, technological knowledge exploded, bringing about changes in production and labor. Methods of making glass, clocks, and chemicals advanced significantly during the 16th and 17th centuries and by the mid-18th century, the state and guild resistance to industrialization had weakened significantly in England and France. Popular interest in industrialization resembled the enthusiasm that had welcomed experimental agriculture a century earlier.

Originally, the 18th century Industrial Revolution referred to the technological developments between 1750 and 1830 that transformed Great Britain from a largely rural, agricultural population to an urban manufacturing society. This Industrial Revolution started in England because England had led the way in developing social and technological innovations. This wave of industrialization spread to other European countries and America during the 19th century, and others, like Russia and Japan, experienced their Industrial Revolutions during the first half of the 20th century.

The English Parliament inspired much of the 18th century Industrial Revolution by permitting lands, that had been held in common by tenant

farmers, to be enclosed into private farms. These enclosure laws increased agricultural production and, at the same time, increased the urban population in England by forcing many landless farmers to move into cities. The English merchant and capitalist interests firmly controlled Parliament, and it passed much legislation favoring mercantile and capitalist interests.

England acquired new overseas territory in every 18th century war that it fought, and during this time, mercantilism thrived in England. Also, England had come to monopolize overseas trade, including trade with its North American colonies. In the 1740s, one half of all British exports went to America, but England also began to control the South American and the Indian trade. All this trade produced the largest merchant marine in the world and a navy to protect this merchant marine fleet, enabling England to dominate the new capitalist economy through its navy.

Inventors also contributed to the English Industrial Revolution. The first factories appeared in 1740, and they concentrated on textile production. James Watt and Thomas Newcomen developed the steam engine, James Hargreaves the spinning jenny, Richard Arkwright the water frame, and John Kay, the flying shuttle and carding machine. From the 1790s to the 1830s, more than 100,000 power looms with 9,330,000 spindles were put into service in England and Scotland. British success with steam locomotion encouraged the building of railroads in most European countries, often with British capital, equipment, and technicians. Britain exported its railroad expertise and after 1842, France began constructing its railroad system. Russia, Canada, and the United States built railroads to link communities and move freight and passengers. In Germany, railroads helped bring about political and economic integration.

## AMERICAN INDUSTRY

America had the closest ties with Great Britain and its expanding industrial capacity. The factory system that had taken root in England revolutionized the manufacture of cotton, thread, and cloth. Improvements in weaving and spinning created a new demand for new carding devices in America as well as England. The most important innovation, steam power, developed after the appearance of James Watt's advanced steam engine patented in 1769. De-

spite the efforts of the British government to prevent the export of English industrial technology, knowledge of the new engines spread quickly to other countries, usually when people emigrated with the learned technology from British factories.

America received most of the benefits of English technology because more immigrants came to America from Great Britain than from any other country. Samuel Slater used the knowledge that he had gained in England to build a spinning mill for the Quaker merchant Moses Brown in Pawtucket, Rhode Island in 1790; it was the first modern factory in America.

The development of the steamboat brought on a new era in river transportation. Inventor Robert Fulton and promoter Robert R. Livingston were responsible for perfecting the steamboat and bringing it to the attention of their fellow Americans. The *Clermont*, equipped with paddle wheels and an English-built engine, chugged up the Hudson River the summer of 1807, demonstrating that steam navigation was the wave of the future. Legend had it that people on the bank, seeing the sparks from the *Clermont*'s smokestack, thought that the devil had sailed by on a raft.

By the 1840s, steamships regularly crossed the North Atlantic. Steamship traffic increased tremendously during the last half of the 19th century and improvements in hull design, engines and fuel further increased traffic. By 1839, the propeller replaced the paddle wheel, steel replaced iron in the hull, and multi-cylinder engines appeared. After 1920, the smaller and lighter diesel engine marked another major change.

The invention of the cotton gin changed the economy of the South and helped New England entrepreneurs develop an American textile industry in the 1820s and 1830s. It also helped drive a wedge between the nation's two most populous regions, with the North becoming increasingly industrial and the South more firmly agricultural. This industrial division ultimately contributed to the Civil War and the eventual Union victory. Eli Whitney developed a machine to make each part of a gun according to an exact pattern.

This made it possible to divide tasks among several workers and one person could assemble a weapon out of parts made by several others. Before long, manufacturers of sewing machines, clocks, and other complicated products were using the same system.



*The steam engine helped thrust Western society into the industrial age with its burgeoning white-collar crime.*

American industry had built a solid foundation before the Civil War, but during the three decades after the Civil War the national economy raced far ahead of the steel rails of the first trans-continental railroad in 1867. The remarkable growth increased the wealth and improved the lives of many Americans. Industrial titans, some the first and most notorious white-collar criminals, and a growing middle class enjoyed prosperity without precedent in American history, but workers, farmers and others experienced poverty and social chaos.

#### MORGAN AND ROCKEFELLER

One of the most important factors leading to the post-Civil War transformation was the transforma-

tion of iron and steel production in the late 19th century. It took capitalists and monopolists like Andrew Carnegie, John D. Rockefeller and J. Pierpont Morgan to furnish the capital and knowledge to build industries like U.S. Steel, the Standard Oil Company, the banking industry, and to insure substantial American economic growth. By the end of the 19th century, as a result of corporate consolidation, 1 percent of the corporations in America controlled more than 33 percent of the manufacturing production. A system of economic organization was emerging that lodged enormous power in the hands of very few men: the great bankers of New York such as Morgan, and industrial titans such as Rockefeller, all of whom, if alive today, would be brought up on major corporate criminal charges.

Henry Ford and his mass production of the automobile in the early 20th century sparked more economic and social changes in American society. Whether or not this relentless concentration of economic power was the only way or the best way to promote industrial expansion became a major source of debate in America in the late 19th century and into the present.

#### EFFECTS OF REVOLUTION

The Industrial Revolution turned out to be a mixed technological and social blessing. It created an increase in population and urbanization and produced new social classes. England and Germany enjoyed a population growth rate of more than 1 percent annually, a rate which doubled the population about every 70 years. In the United States, the increase averaged to more than 3 percent, a rate that could have produced disastrous results if the continent had not been practically empty and overflowing with natural resources. Only the population of France remained fairly static after the 18th century. The growth of medical science and public health measures helped decrease the death rate.

The Industrial Revolution transformed the population from a rural to urban base. By the mid-19th century, half of the English people lived in cities and by the end of the century, this was also true of other European countries. Between 1800 and 1950 most large European cities enjoyed spectacular growth. At the beginning of the 19th century, there were scarcely two dozen cities in Europe with a population of 100,000 but by 1900, more than 150 cities in Europe had reached this size.

"We cannot all live in cities, yet nearly all seem determined to do so," Horace Greeley wrote shortly after the Civil War. America's urban population increased sevenfold in the 50 years after the Civil War, and the 1920 census revealed that for the first time a majority of the American people lived in urban areas.

Around the industrial world, middle classes expanded and, in varying degrees, came to dominate the economy of their nations. Urban living intensified conditions like poverty, lack of good housing, and class divisions. Factory towns in England and America tended to spawn tenements and the mining towns produced rows of company cottages providing little but minimal shelter. Unlike rural landlords and local aristocrats, factory owners and managers were usually remote and inaccessible and tended to regard laborers as commodities and not as human beings. They dealt with their workers impersonally and eventually there was a growing schism between the two classes. Working men and women all over the world grew to think of themselves as a distinct class with common goals and interests. Clashes with management created social turbulence.

The Industrial Revolution created a new working class that included all the men, women, and children laboring in the textile mills, pottery works, and mines. Often, skilled artisans found themselves demoted to laborers as machines began to mass-produce the products formerly made by hand. As a rule, wages were low, hours long, and working conditions unpleasant and dangerous. The nature of labor changed. It was fixed, disciplined, routinized work with a fixed and rigid schedule, a sharp contrast to the varied seasonal working pattern of the rural economy.

The industrial giants of the late 19th century in America and Europe created their own economic systems that spurred great economic growth. They integrated operations, cut costs, built a great industrial infrastructure, stimulated new markets, created jobs for a vast new pool of unskilled workers and opened the way to large-scale mass production. They also laid the foundation for some of the greatest public controversies of their era and of ours. Modern industrial cities produced great increases in pollution, crime and infectious disease as well as culture and economic opportunity. The problems of poverty, the degradation of the environment, the spectre of monopoly, the question of wages and working conditions, the struggle to unionize,

strikes—all of these creations of the Industrial Revolution are still being addressed in the 21st century.

#### SEE ALSO

capitalism; labor crimes; unions; Morgan, J. Pierpont; Rockefeller, John D.; Standard Oil; U.S. Steel; antitrust; Sherman Antitrust Act.

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## infant formula

**BEGINNING IN THE** early 1970s, an international scandal developed over the advertising of infant formula in developing countries. The chief objection to marketing infant formula in these countries was that it encouraged mothers to choose not to breast-feed their babies, even though medical and children's experts around the globe, including the World Health Organization (WHO) and United Nations, were convinced of the health benefits of breastfeeding for at least the first six months of an infant's life.

Critics argued that the use of infant formula also threatened the health and lives of children in developing countries for a number of other reasons. First, many mothers were illiterate and could not read the directions on how to correctly prepare the formula. Even those mothers who could read sometimes chose to dilute the formula to make it go further because it was expensive. Storage facilities

were often inadequate or nonexistent for the formula once it was put into bottles, so formula often spoiled. Additionally, many mothers had no way to sterilize water, bottles and nipples or to maintain sterility if it were achieved.

### QUESTIONABLE MARKETING

Critics of infant formula also claimed that mothers in developing countries were prejudiced toward choosing formula over breastmilk by a number of questionable marketing techniques. The most controversial technique was the use of "milk nurses" who were hired salesgirls dressed in white nurse-like uniforms whose only goal was to sell their employers' products.

Infant formula manufacturers were also harshly criticized for labeling their products with photos of fat, health Caucasian babies who conveyed the message that undernourished children in developing countries would become healthier by using the imported formula. Infant formula manufacturers also freely distributed samples of their products through hospitals, doctor's offices, and "milk nurses." Critics were also opposed to the media blitz that included radio, television, and print advertising aimed at selling infant formula.

As the controversy over advertising infant formula in developing countries spread around the world, a flood of negative publicity resulted, including scientific reports, public statements, books, films, investigations, demonstrations, boycotts, congressional hearings, and international meetings. The climax came on May 21, 1981, when the World Health Assembly (WHA) passed the International Code of Marketing of Breast-Milk by a vote of 118 to 1. The only holdout was the United States because the Ronald Reagan administration argued that the Code restricted free trade. Senator Mark Hatfield (R-OR) accused the Reagan administration of being indifferent to the sanctity of human life, and two top officials of the U.S. Agency for International Development resigned in protest.

The World Health Organization (WHO) and UNICEF banded together to encourage mothers in developing countries to breastfeed their babies and lobbied governments in developing countries to adopt the WHA Code, which stipulated: "There shall be no advertising or other form or promotion in the general public of breast-feeding substitutes." The WLO and UN often referred to the Central

American country of Guatemala as the ideal model for illustrating the benefits of adopting the WHA Code because the infant mortality rate dropped drastically in Guatemala after the government implemented the Infant Formula Marketing Code. All manufacturers who imported infant formula or baby food to Guatemala agreed to remove baby pictures on their labels for children under two years of age except Gerber. Gerber refused to abide by the restrictions and threatened to challenge Guatemala's adoption of the Code through the World Trade Organization, which would have placed an unfair financial burden on the country. In 1995, the Guatemalan Supreme Court exempted imported baby food from Guatemala's strict infant health laws.

A scandal erupted in Israel in mid-November 2003 when three Israeli infants died and several others were hospitalized after ingesting a soy-based formula manufactured by Humana, a German manufacturer. The company claimed that its failure to include vitamin B-1 in the infant formula was due to human error and accepted full responsibility for the mistake. The absence of B-1 in infant formula can cause beriberi, which in turn can lead to cardiac and neurological problems or death. Israeli authorities decided to investigate the possibility that Israeli infants had been targeted for political reasons because of resentment against the Jewish state.

### FOOD AND DRUG ADMINISTRATION

Infant formula sold in the United States is generally safe. While the Food and Drug Administration (FDA) is not required to approve infant formula before it is released, the Infant Formula Act requires that manufacturers of infant formula provide the FDA with certain information before a new formula can be released on the market.

This information includes nutrient levels and extensive test data on the product. Congress has also given the FDA the authority to create and enforce standards on all infant formulas that are sold commercially. Despite the best intentions of the FDA, counterfeit formulas are occasionally released on the market. The FDA recommends that parents do not feed their infants any formula with an unusual color, smell, or taste, or any which contains an outdated expiration date.

Because FDA regulations require that every batch of infant formula sold in the United States

contain an identifying number, the task of recalling formula when a problem occurs is facilitated. For instance, in November 2002 Wyeth Nutritionals, Inc. recalled an entire batch of infant formula that had been distributed nationwide due to the possibility that the formula was tainted with *Enterobacter sakazakii*, which can cause severe intestinal infections or meningitis (inflammation of the brain), which can lead to death in newborns.

In the summer of 1997, authorities uncovered an international black market for infant formula operating out of Fort Worth, Texas. Ten locally-owned convenience stores were paying drug addicts from \$6.00 to \$9.50 per can to shoplift cans of infant formula. The cans were then placed in boxes that were fraudulently labeled Enfamil, Isomil, and Similac, the names of legitimate infant formula manufacturers. Some cans were sold domestically for \$12 to \$16 a can.

More often, the cans of formula were sold internationally, particularly to Arab countries, for up to \$40 a can. Authorities in Fort Worth seized 1 million cans of the fraudulent infant formula and 100,000 packing boxes. They then froze bank accounts of suspected participants in the black market ring.

#### SEE ALSO

Food and Drug Administration; Israel; Beech-Nut Corporation.

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## insider trading

IN MOST JURISDICTIONS, insider trading can be legal, or illegal. Legal insider trading occurs when corporate insiders buy and sell stock in their own companies. When corporate insiders trade in their own securities, they must report their trades to the securities regulator. Illegal insider trading, a type of white-collar or corporate crime, refers to situations where a person deals on the basis of price-sensitive information which is not in the public domain. And at the time of the dealing, the information is likely materially to affect the price of the securities being traded. Two main types of illegal insider trading exist: the use of insider information by an insider for self enrichment, and the leaking of information by an insider to a third person (tipping), causing the third person to engage in illegal trade practices.

Illegal insider trading exists worldwide and affects all financial markets. It is one of the major challenges of our time. Millions of dollars have been involved in big insider-trading cases. Although the phenomenon of insider trading is not new and arguments against it existed in the early years of the past century, it did not become a major interest of the media and the public until recently. Since the 1980s, insider trading has increasingly become a hot topic. Some scholars refer to it as “the representative white-collar crime of the 1980s.” The increasing media reports of business morality cases in securities markets makes the topic of insider trading even more popular among the public.

#### ANTI-REGULATION

It is certainly not universally agreed that insider trading should be prohibited. Some economically oriented scholars argue that regulating insider trading is wrong. They assert that insider trading is a constructive form of compensation for entrepreneurs or managers and thus makes the market more efficient. They argue that insider trading is a sort of compensation scheme for entrepreneurs who produce information, and believe that long-term investors will not be hurt by the practice.

The entrepreneur is vital to the development of the corporation and must be encouraged to continue to produce information. Otherwise, the entrepreneur will “disappear from the corporate scene.” The supporters of insider trading also argue that insider trading enables quicker dissemination of good or bad news and incorporates information into the

share price more quickly, thus allowing all investors to react more quickly. If insider trading was legal, this group argues, insiders would bid the prices of stocks up or down in advance of the information being released. The result is that the price would more fully reflect all information, both public and confidential, about a company at any given time. Even if insider trading sometimes creates more harm than good, rules against it could be contractual rather than mandated by government, because insider trading is a kind of “private ordering” or employment contract between the corporation and its shareholders. Advocates say the government should not intervene in the private contract by regulating insider trading practices.

### PRO-REGULATION

Regulation proponents have formulated the best reply to these arguments. They argue that remuneration of entrepreneurs is a matter of contract between them and the corporation. Explicit executive compensation schemes are fully capable of compensating valuable hard-working managers. An insider who makes no contribution to the issuer may also profit from insider knowledge of adverse events within the corporation. There is little need to use insider trading as a compensation device to induce the managers to work hard.

Contrary to insider trading supporters, proponents of insider trading regulations argue that prohibiting insider trading will help the allocative efficiency of the market. Since prohibiting insider trading should improve the speed of disclosure, more information will then be incorporated into the market price. Rules against insider trading are not “private ordering,” because shareholders do not communicate well with each other and, therefore, will not work together to negotiate with corporate insiders to create a contract preventing insider trading.

Unlike those who focus on economic analysis, many legal scholars, criminologists, and other social scientists generally condemn insider trading and support insider trading regulations. The justification for regulating insider trading has revolved around issues of fairness, market confidence, and fiduciary responsibility.

The classical argument against insider trading is that it is inherently unfair for a person to use confidential information acquired by virtue of her spe-

cial status to trade to the detriment of the other party, who is ignorant of the existence of the information. Allied to this is the argument that insider trading is immoral. The clamor for insider trading regulations in the 1920s and 1930s in the United States hinged on fairness arguments. Some of the advocates of these arguments, while realizing the obvious economic benefits of allowing insider trading, contended that such benefits do not outweigh the benefits to be realized from ensuring fairness in the securities market.

Although the above arguments still find currency with a few scholars, most researchers argue that immoral acts cannot automatically be translated into illegal and criminal behaviors. Such fairness arguments are probably used as a specious cloak of legitimacy to mask the theoretical difficulties of insider trading regulation in some jurisdictions. A pertinent question is: whose morals are the regulations supposed to protect? Notions of fairness and morality are as disparate as there are interest groups to serve.

Another pro-regulators’ favorite argument is that insider trading destroys the confidence of investors in the securities market. If the market allows insider trading, the public investors will lose confidence in the securities market and will be reluctant to invest in the market. When trading on confidential information is outlawed, investors will trade with the confidence that stock prices reflect their actual value. The proper basis for regulation is, therefore, the need to preserve the expectation of fairness needed to maintain investors’ confidence in the security market.

Some authors argue that insider trading based on privileged information is a breach of the fiduciary obligations owed to the company. It is further said that allowing insider trading will lead to a conflict of interest in that insiders will be more interested in inventing and shielding information upon which they can trade instead of concentrating on the business of the company. They argue that insider trading and other offenses in securities markets are essentially the violation of trust. They maintain that trust is truly the foundation of capitalism. Based on this assumption, these authors advocate formal enforcement of securities laws to crack down on such illegality.

There is also a resistance among regulation advocates against the idea that insider trading is a victimless crime. Some scholars argue that, in an



insider-trading transaction, there is a party who loses value from the securities involved or is forced to take a loss. Thus, they prefer viewing insider trading as “a crime with an unknowing victim.” Some researchers have identified victim populations in their study and find that they were mostly individual stockholders at the time of victimization. Many proponents of stronger insider-trading laws argue that, even though it is difficult to show a direct causal link between the activities of the insider, the decision of the outsider to deal and the loss incurred, it might still be possible to regard the outsider as a victim of an informational advantage.

## REGULATION STATUTES

A combined approach may reconcile the tense debate between regulation proponents and opponents. Fairness, market confidence, and economic efficiency should all be considered before an appropriate model of regulation is adopted. To achieve fairness and market confidence, formal regulatory measures may serve the long-term interests of society. To attain temporary market efficiency, a self-regulation system such as a “Chinese Wall,” which is aimed at stopping the flow of information from one department in a corporation to another, may be adopted.

The legal attitude toward insider trading in history has obviously reflected a *laissez-faire* philosophy instead of a government control approach. The illegality of insider trading on non-public information had not been established until the early 20th century. In the United States before 1909, for example, there was no legal obligation for an insider trader to disclose nonpublic information. The only exception was the case of fraud that was not easy to prove. The adoption of “blue sky laws” in early 1900s, however, required the full disclosure of material nonpublic information. In the leading case of *Strong v. Repide* in 1909, the U.S. Supreme Court established that a company official is obliged to disclose her identity and nonpublic information when she trades the company stocks. Section 10(b) and Section 16 of the Securities Exchange Act of 1934, the landmark U.S. Supreme Court case of *SEC v. Texas Gulf Sulphur* in 1968, and the following cases made further legislative and judicial confirmation of the illegality of insider trading on privileged information. Similarly, in other jurisdictions like Canada, Britain, and Australia, legislation was even-

tually introduced that made trading on insider information a crime, although they may regulate insider trading in different ways.

The regulation of insider trading in the United States rests primarily on section 16(b) and section 10(b) of the Securities Exchange Act of 1934. Section 16(b) prohibits short-swing insider-trading profits (profits realized in any period less than six months) by those most likely to be privy to material nonpublic information. It applies only to directors or officers of the corporation and those holding greater than 10 percent of the stock. Section 10(b) makes it unlawful for any person “to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe.”

Section 10(b) of the Securities Exchange Act of 1934 is a broad anti-fraud provision, which generally prohibits fraud or misrepresentation in connection with the purchase or sale of a security. Rule 10b-5, promulgated under section 10(b) in 1942 by the Securities and Exchange Commission (SEC), is a more comprehensive anti-fraud provision used as the major weapon to curb insider trading in the United States. It simply prohibits any person from committing any fraud in connection with any securities trading. Congress did not specify the definition of insider trading as a fraudulent act. Instead, Congress left this for the courts to interpret. The lack of a clear legislative definition allows the SEC to construct its own interpretations, subject to judicial scrutiny. It is on the basis of these provisions that the courts and the SEC has exercised its authority to make the most important developments in insider-trading law in the United States.

The civil and criminal penalties for insider trading are also included in the Securities Exchange Act of 1934. First, there are private civil remedies, as found in section 20(a) of the 1934 Act. Persons who are harmed by insider trading can bring actions in most circumstances to recover the illegal profits (or avoided losses) enjoyed by wrongful traders in contemporaneous trading. Furthermore, the SEC has the authority to impose criminal penalties, civil penalties, and punitive civil awards against wrongful traders.

The lack of successful enforcement efforts by the SEC from the enactment of Rule 10b-5 to the

late 1970s led the SEC to formally request that Congress increase the civil penalty for insider trading. The Insider Trading Sanctions Act of 1984 gives the SEC the power to seek additional remedies in insider trading cases. The 1984 act also increased the maximum amount of the fine from \$10,000 to \$100,000.

The Insider Trading and Securities Enforcement Act of 1988 broadened the scope of illegality by imputing civil liability to "controlling persons" for the violations of their employees, or "controlled persons." The maximum penalty for criminal violation has been increased from five years to 10 for imprisonment, while the maximum fines for individuals increased from \$100,000 to \$1 million and was increased against non-natural persons (for example, corporations, exchanges, etc.) from \$500,000 to \$2.5 million. The SEC is empowered to award bounties of up to 10 percent of penalties recovered, through litigation or settlement, to informants who provide information leading to successful enforcement actions against insider traders.

The SEC was created by section 4(a) of the Securities Act of 1934 to enforce the U.S. securities regulation. Under the securities laws the commission can bring enforcement actions either in the federal courts or internally before an administrative law judge. It is the most powerful securities regulator in the world. Since the depths of the Great Depression, the SEC has tried to prevent insider trading in U.S. securities markets. The number of insider-trading enforcement actions brought by the SEC increased dramatically in the 1980s. A U.S. General Accounting Office Report states that there were only 53 insider trading cases brought by the SEC from 1934 to 1979, while 177 cases from 1980 to 1987. The pursuit of high-profile insiders in the late 1980s, starting with the prosecution of Dennis Levine at Drexel Burnham Lambert, has instilled in the public a sense of justice.

Because insider trading undermines investor confidence in the fairness and integrity of the securities markets, the SEC has declared the detection and prosecution of insider trading violations as one of its enforcement priorities. About 45 insider-trading cases are pursued every year. The SEC brought 57 cases alleging insider trading in 1997 alone. For the most part, however, most of the offenders caught today are employees pocketing a quick \$5,000 after buying shares of a company's stock before a merger. Furthermore, criminal prosecutions

for insider trading tend to be fewer and difficult to win, partly because it is rather difficult to prove what the accused actually knew at the time the trades were made. Insider trading is usually committed by the wealthy and powerful, who can afford the best lawyers and have rich resources to drag a case out and cost the prosecutors millions along the way. Given the court's scrutiny of insider trading cases, the SEC's role as enforcer is made more difficult.

## INTERNATIONAL REGULATION

The American style of insider trading regulation has set a major global trend and has been adopted especially by Japan, Taiwan, South Korea, the Philippines and some countries that have recently developed their securities markets, such as China. Insider trading prevails in these countries, with politicians among the main beneficiaries.

These countries, for the most part, copied securities regulations from the United States. Some provisions are even stricter than the U.S. regulations on paper. Although these countries have made efforts to tighten insider trading regulations, there have been only a few cases under these regulations. The borrowed insider-trading regulations still do not work well in their own jurisdictions, partly because there is no effective independent regulator in these nations.

There are two major styles of insider-trading regulations other than the U.S. style in the world, both originated from the European countries. The UK style can be found in the United Kingdom, the Republic of Ireland, Australia, Hong Kong and other Commonwealth jurisdictions. The continental European countries' style is adopted by most civil law jurisdictions in continental Europe. The European countries have tried to harmonize their insider-trading regulations, which were formalized in the European Community Directive Coordinating Regulations on Insider Trading, adopted on November 13, 1989 (the EC Directive). The EC Directive arose out of the 1957 Treaty of Rome establishing the European Economic Community, which mandated creating a single internal European financial market.

At the time the directive was passed, however, four of the 12 members of the EC (West Germany, Belgium, Italy and Ireland) had no insider-trading legislation on the books and the remaining eight members (France, England, Luxembourg, the

Netherlands, Denmark, Greece, Portugal and Spain) had widely varying statutes. The directive set up a minimum standard of insider-trading regulations and required all member states to follow it.

The statutes are, nonetheless, not self-enforcing in practice. Germany and Italy, for example, have traditionally viewed insider trading as an acceptable market practice. Insider trading is an extraordinarily difficult crime to detect and prove, especially in the cultures where insider trading is not considered a crime. There has not been a significant insider-trading case brought by the regulators either in Germany or Italy. In 1998, Dutch authorities enacted its new law providing for criminal penalties only against insider trading. Although the statute is regarded as the "toughest in the world," Dutch prosecutors have made only one insider-trading prosecution in the last 15 years.

The UK was one of the first European countries to enact laws against insider trading. The Company Securities (Insider Dealing) Act of 1985 (IDA1985), making insider trading a criminal offense, is designed primarily to prevent corporate insiders, quasi-insiders (anyone who has a professional or business relationship with the issuer, and public servants or former public servants) and tippees, from insider trading. Under IDA1985, a person convicted of insider trading may be sentenced up to six months in jail or receive a fine not exceeding the statutory maximum or both. If the person is convicted of insider trading upon indictment in the Crown Court, he can be sentenced up to seven years or to an unlimited fine or both. It should be pointed out that, however, the enforcement record has been disappointing. Since IDA1985, the conviction rate under the law has been rather low at only about 50 percent. Some authors argue that the low conviction rate of insider trading is the fault of the too tightly drawn definition of "insider" in the UK statute.

Many commentators attribute the low conviction rate of insider trading to the fact that insider trading is only a criminal offense in the UK, making successful prosecutions very difficult. They argue for the U.S. style that has used a combination of the criminal as well as the civil approach in dealing with insider trading cases, because the burden of proving a purely circumstantial case is less onerous in the civil context. Furthermore, it has been criticized that enforcement and regulation powers were spread among separate front-line regulators respon-

sible for particular sectors of the market, which may affect effective enforcement.

Legal reform is called to enforce laws against insider trading offenses. In May 1997, the chancellor of the exchequer announced the reform of financial services regulation in the UK and centralized enforcement powers in the UK's Financial Services Administration (FSA), which has far-reaching new powers to crack down on insider trading, including the power to impose unlimited civil fines for insider trading. The FSA was given statutory powers by the Financial Services and Markets Act 2000. The FSA, modeling itself on the SEC, has subpoena power, the power to punish non-cooperation and to order wrongdoers to make restitution. To date in early 2004, the FSA has barely scratched the surface of insider trading, and thus has a long way to go against the wayward insider traders.

Today, many countries have a consensus on the need to reinforce insider-trading regulations, because insider trading will damage investors' confidence in the securities market. While the globalization of the securities markets has enabled insider trading to become a very natural international practice, it is even more difficult for securities regulators to pursue transnational insider trading cases. Some countries have bank secrecy legislation or blocking statutes to prevent foreign regulators from acquiring necessary information for an insider trading case. Even the powerful and aggressive SEC has been frustrated by foreign authorities for enforcement cooperation. Current international agreements and treaties serve little use for investigating transnational insider trading cases. The Memorandums of Understanding (MOUs) signed between countries help deal with such cases, but not every country has an MOU with another country regarding mutual assistance on investigating transnational cases.

#### SEE ALSO

securities fraud; stock fraud; investment fraud; Drexel, Burnham, Lambert; Stewart, Martha; Insider Trading Sanctions Act; Securities and Exchange Commission.

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## Insider Trading Sanctions Act

IN AN EFFORT to curb insider trading, the Insider Trading Sanctions Act (ITSA) was signed into law by President Ronald Reagan on August 10, 1984. ITSA amends the Securities Exchange Act of 1934 which reflects a longstanding concern with fair and equitable markets. According to the Securities and Exchange Commission's (SEC) Division of Enforcement, insider trading is the most difficult and most serious challenge they face. Curiously, neither the Securities Act (1933) nor the Exchange Act define insider trading, forcing the SEC to construct various legal theories on the basis of the general anti-fraud provisions of these acts.

Reflecting this longstanding perspective on flexibility in defining insider trading, Congress (in its deliberations for ITSA) took no action in defining the term but favored continuing to give the SEC the widest possible flexibility in dealing with potential new versions of insider trading schemes. Both ITSA and its 1988 counterpart, Insider Trading and Securities Fraud Enforcement Act (ITSFEA), are designed to curb trading on "inside information"—the use of confidential information entrusted to insiders and not available to the investing public.

ITSA increased the sanctions under the Exchange Act for insider trading violations with the possibility of a civil penalty equal to three times the profit gained or loss avoided against persons who unlawfully traded in securities while in possession of material non-public information, or who unlawfully communicated such information to others

who then traded (that is, on the basis of that information or tip). ITSA also increased from \$10,000 to \$100,000 the maximum criminal fine for any violation of the Exchange Act (which was later moved to \$250,000 by the Criminal Fine Improvements Act).

### PUNITIVE THRUST

The General Accounting Office (GAO) specifically points to the ITSA's "punitive thrust" in that, prior to 1984, the civil monetary sanction was only remedial and required that the insider give back any profits realized or losses avoided. SEC enforcement officials also cite the combined impact of ITSA with ITSFEA with the latter extending the scope of civil penalties (controlling persons who fail to take measures to prevent insider trading by their employees). However, these officials also cite the high threshold of proof for the commission to establish, given the complexity of these dealings and the many routes of access to inside information (for example, lawyers, accountants, and printers of legal documents).

To understand ITSA's impact, an assessment of the past enforcement activities of the SEC can aid in evaluating its ability to use available sanctions and remedies. SEC enforcement officials cited the continuing impact of act well into the 1990s in celebrated insider-trading cases surrounding large corporations like Pillsbury. Reflecting the broadened SEC authority, there was a dramatic increase between 1978 and 1985 in insider-trading cases and the GAO found that the number of insider-trading cases increased dramatically in the wake of the Act—from 12 to 45, while the amount of profits surrendered by perpetrators jumped from \$2 million in 1985 to \$30 million in 1986. The immediate impact of ITSA (identified by GAO) can be observed in the jump in ITSA-specific penalties from \$158,492 in 1985 to \$3,889,269 in 1986.

A potential downside to the act anticipated by the SEC was increased resistance from defendants and respondents (to SEC investigations) because the SEC had been seeking stiffer penalties. Also, enforcement officials cite the challenge mounted by some that insider trading is ambiguously defined, and therefore shouldn't be prosecuted even though insider trading has fallen under the general anti-fraud provisions of the securities laws, and comes under the authority specifically granted the SEC (under the 1934 Exchange Act) that the commission

shall promulgate rules to determine the scope of anti-fraud liability. These types of cases do not appear to be over-criminalized.

#### SEE ALSO

securities fraud; insider trading; Stewart, Martha; Securities and Exchange Commission; Milken, Michael.

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## insurance fraud

INSURANCE IS THE PRESUMED protection against a possible loss in exchange for a predetermined fee, which assumes a fee low enough to make the purchase of insurance attractive to the purchaser, but still generating a profit for the company supplying the coverage. Insurance coverage ranges from the mundane (car, life, flood, health) to the exotic (singer's voice, athlete's arms, weather on a certain day). Both parties to an insurance transaction must be amenable to the cost of the coverage.

Insurance fraud occurs when either the seller or buyer of the policy attempts to alter the process to obtain more coverage or profits than entitled, or when third parties to the insurance coverage (for example, medical care providers, automobile repair shops, and claimants) make exaggerated or totally

fraudulent claims. Insurance fraud can involve issues of no coverage, exaggerated claims of damages, staged accidents, and falsified documentation.

Insurance-fraud costs to policyholders have been estimated as \$160 billion annually. Insurance companies have created specialized investigative units (SIUs) to combat this fraud. Their efforts are assisted by a national insurance-fraud bureau as well as by increased prosecution efforts by state prosecutors; additionally there seems to be a change in public sentiment, considering insurance fraud to be a crime rather than a way to gain equity against increasing premiums. There appears to be a correlation between tough economic times and increases in insurance fraud.

#### SELLER FRAUD

Insurance fraud from the seller side (which can involve one representative or entire companies) includes:

*Issuing coverage from non-existent companies:* policy premiums are obtained from consumers, but the policy is written against a non-existent company. The fraud is discovered when a claim is filed. This type of fraud is a planned criminal operation, often working out of "boiler room" operations (ad hoc, temporary offices). The sales are generated through the promise of exceptionally low premiums, which usually produces word-of-mouth referrals. If an accident claim is filed early in the operation, sometimes a phony claim process is begun, making partial payments so as not to reveal the fraud.

*Failure to submit premiums:* in these cases, a representative of an insurance company collects premiums from a policyholder but doesn't remit payments to the company. The customer believes that coverage is in force until a claim is refused for non-payment of premiums. This type of fraud is often caused by economic pressures upon the agent, in which she may have originally planned to use the premiums for a short-term loan, but was unable to pay the premium before a claim occurred.

*Churning:* a procedure by which an insurance company salesperson convinces customers to cancel and renew policies, not for the benefit of the customer but to generate additional commissions for the salesperson. The customer often pays more in commissions than is necessary, and receives no increase in policy value. This is a fraud type often perpetrated against older policyholders.



*Suicide disguised as accidental death is one form of insurance fraud.*



*Seller fraud involves pushing buyers to acquire inappropriate coverage.*



*Viatical fraud involves brokering policies to obtain immediate cash.*

*Inappropriate coverage:* in these cases, sales representatives convince policyholders to obtain policies for which they may already have coverage or for coverage that they do not need.

#### BUYER AND THIRD-PARTY FRAUD

Insurance fraud from the buyer and from the third-party side includes:

*Life insurance coverage—post-dated policies:* these life insurance policies are obtained after the death of an insured, with or without complicity from a salesperson. A policy is post-dated to show coverage prior to the death of the insured. In some cases, the insurance agent has said the intent wasn't personal gain but to assist the family; regardless of the intent, the action is criminal fraud. Other cases were simply conspiratorial frauds, between an agent and a family member of the deceased, to illegally obtain policy proceeds from the carrier.

*Fraudulent medical history:* an applicant falsifies medical history information to acquire coverage for which she would not normally qualify. The falsification could be a failure to list a pre-existing medical condition or submission of fraudulent documentation. The insured would hope to obtain health insurance coverage for a "reasonable" price, that is, not what a person with a pre-existing illness would pay if a policy was available; hoping that falsification of medical history would not be discovered.

This action would be similar to the under-reporting of total miles driven on an application for automobile coverage.

*Murder for insurance proceeds:* a life insurance policy is exercised on an unsuspecting party, so that the later intentional death can be exploited for profit. These cases include incidents where the policy was originally secured with no criminal intent (spouse, business partner, family member) but the insurance coverage later became a factor in the insured's death; and cases in which the policy was secured with criminal intent already planned, obtaining coverage with murder as precipitating factor for securing the policy.

*Lack of insurability:* a policy is taken out on an individual whom the policy-holder has no insurable interest in the individual. In these cases, an individual claims to have an insurable interest (family member, dependent, business partner) and proceeds to purchase insurance coverage, especially when the insured's death is forthcoming. The insured's death may be of natural causes rather than an intentional act. The person securing the policy is assuming that the policy proceeds will outweigh the policy costs.

*Suicide disguised as accidental death:* a case in which a person wants to commit suicide and still obtain insurance proceeds for family members. In some cases, local medical examiners and coroners are complicit in these frauds as they know the fami-

lies are in need of the proceeds, or respond to religious or societal pressures from family members or friends. Usually, there is no conspiracy between the insured and the medical examiner. The insured hopes to disguise the intentional nature of death, while the medical examiner decides to classify the death as a suicide out of compassion. In most jurisdictions in the United States, the coroner/medical examiner determines the cause of death, and if the ruling is accidental or natural there are no grounds for a police investigation.

*Faked death:* a case in which a person desires to fake his death but obtain insurance proceeds for either himself or his survivor(s). Often, these cases involve an insured with criminal charges pending. The staging of death accomplishes two goals, financial assistance to the family and termination of the criminal investigation. This case type also involves the filing of claims in which no death actually occurred, as noted in several cases resulting from claims made in the 2001 World Trade Center collapse. Some prosecuted cases involved claims on family members who were dead, and others were filed on non-existent persons.

*Viatical fraud:* viaticals are companies that broker life-insurance policies obtained from policyholders who require a quick cash settlement to pay current medical bills, to investors who, in turn, purchase them for less than face value. The majority of viaticals involve terminally ill insureds. In return for the immediate cash settlement to the policy-holder, the investor receives the face value of the policy when the insured dies. Frauds occur when healthy insureds falsify medical records to obtain viatical settlements. If fraud is discovered within two years of the policy date, the policy can be revoked.

## PROPERTY FRAUD

Insurance property fraud involves:

*Staged car accidents:* one or more persons stage automobile accidents and file insurance claims for property as well as personal injuries, with some injuries exaggerated by intentional infliction of trauma. In this fraud type, all drivers are involved, often rotating the role of victim and at-fault driver. These cases often involve rental cars that have been rented with full insurance coverage. To enhance the total dollars awarded, perpetrators of this scam have been known to inflict personal injuries upon themselves if the collision didn't produce the de-

sired effects, including pulling out teeth with pliers and breaking their own arms.

*Intentionally caused car accidents:* cases in which unsuspecting motorists are "forced" into having accidents. Due to skillful driving by co-conspirators, an innocent victim has an accident with another member of the conspiracy, but reconstruction of the accident by the police will show that the unsuspecting motorist was the one who "caused" the accidents. False testimony is sometimes offered by the co-conspirators to strengthen the case against the victim. (This fraud type is also used in liability claims.)

*Non-coverage falsification:* these are cases in which insurance coverage is alleged, even though the claimant knows that no coverage was in effect. This case type may include damages resulting from uncovered damage, but a fraudulent claim is presented under another coverage source, that is, a homeowner accidentally destroys her computer system and files a police report that the computer was stolen in a burglary.

*Arson for profit:* cases in which a property owner intentionally destroys his property and files an insurance claim to recover the insured value of the policy. This fraud type can concern cases in which the policy was purchased with the plan of arson already in place, or cases in which dire economic or personal reasons caused a policy-holder to contemplate arson after the purchase of the policy.

*Fraudulent criminal loss:* a case in which a claim is made for fictitious losses resulting from an alleged crime, that is, claiming a non-existent expensive watch during a robbery, or made-up property from home during burglary. This case type involves insureds who want to "recoup" their deductible, and others who falsify the event in order to collect money.

## WORKER COMPENSATION FRAUD

Insurance fraud against worker compensation plans include:

*Lack of coverage:* these are cases in which an employee is injured in a situation not covered by worker compensation coverage, for example, fooling around, injury occurring off duty, or an intentional act; but the employee proceeds to claim that the injury did occur as part of her employment and qualifies under worker compensation coverage. This case type often involves persons who did not

acquire personal health insurance and sustained an injury (an accident) that required attention.

*Exaggerated injuries:* in these cases, persons injured in a legitimate worker compensation accident present claims for exaggerated damages, often supported by false testimony from medical specialists. In some cases, insured persons receiving worker compensation benefits are found performing employment tasks (lifting, reaching, etc.) at “under the table” cash jobs. Some worker compensation claimants attempt to justify their actions by arguing that the amount of payment (usually 66 percent of base pay) is not sufficient to live on.

*Premium fraud:* employers falsely under-report the number of employees on the payroll to reduce worker compensation premiums, increasing the risk to the carrier without a premium offset. Additionally, in some incidences, to lower the number of reported claims, employers may entice injured employees not to file accident reports, sometimes through compensation and sometimes through threats of termination.

## LIABILITY FRAUD

Insurance fraud involving liability includes:

*Staged accidents:* cases in which persons stage accidents to make a claim against a third party, on the assumption that insurance coverage is in effect and the claim will be settled to avoid extensive legal fees, such as an intentional slip-and-fall in a business. Some fraudulent liability claimants have documented histories of incidents of unwitnessed injuries, or witnessed only by friends or family.

*Exaggeration of injuries:* persons injured in an accident present claims for exaggerated damages, often supported by false testimony from medical specialists. The actual injuries are often inflated to produce higher settlements or to push for a faster settlements, before the injuries “worsen.”

*Paper accidents:* cases in which no accidents occurred, yet falsified documents are submitted to show proof of damages and loss (also used with property claims.) These cases often involve complicit police and medical personnel, and attorneys.

## DISABILITY, UNEMPLOYMENT FRAUD

These specific insurance fraud cases include:

*Falsification of coverage:* a case in which a person desiring medical treatment yet has no coverage, as-

sumes the identity of a person who does have coverage (with or without the knowledge of the insured person). Additionally, some elaborate frauds have set up phony call centers to verify coverage of the “insured” to the hospital.

*Disability claims, fraudulent disability claims:* cases in which holders of disability policies exaggerate the extent of their illnesses to receive compensation for additional periods of time. The exaggeration may be purely subjective in nature (“my back still hurts”) or forged documentation may be provided in an attempt to objectively verify the exaggeration.

*Unemployment compensation, concealment of employment:* cases in which a person originally entitled to unemployment benefits fails to disclose his non-eligibility (new employment) and receives both unemployment benefit payments as well as a salary. Again, fraudulent claimants attempt to justify their actions arguing the weekly payments are too low keep up their lifestyles.

## HEALTHCARE FRAUD

Insurance fraud in the healthcare industry can include:

*False statement of service rendered or goods provided:* cases in which medical treatments delivered to patients are mis-stated to the insurance carrier. This fraud type sometimes involves “upcoding,” in which one procedure billed includes more items than what was delivered to the patient. This could involve billing for a more comprehensive series of tests than the ones actually performed. Mis-statement may involve cases in which actual services were rendered but over-billed, or cases in which the record of treatment was totally fraudulent. Patients may have been seen for another complaint, and fraudulent treatments were noted on their charts, or cases where no patient was present but billing was produced for fictitious services.

As with some other fraudulent insurance cases, offenders argue that their actions were to compensate them fairly. In January 2003, the attorney general of New Jersey reported the arrest of a drug and alcohol rehabilitation and substance abuse counselor with multiple counts of healthcare fraud, alleging more than \$500,000 in fraudulent billing to Medicaid over an 18-month period. It was alleged that none of the billed services ever occurred, nor had any of the “patients” ever been to the coun-



selor; the patients' names and recipient identification numbers were obtained fraudulently.

*Unreasonable rates:* in these cases, healthcare organizations charge rates in excess of their contracted markups, claiming a higher cost level than the actual costs. In other cases, the rates are fraudulently increased through "unbundling," which involves splitting a comprehensive charge into two separate charges that generate a higher price. While the services were rendered together as noted by the comprehensive charge, the insurance company is billed for two separate procedures, each with their own markup.

*Unnecessary treatments:* in these cases, unnecessary treatments are delivered to the patient by the healthcare provider even though there were no medical indications that the services were required. Normally, these services provide no positive impact for the patient rather they simply generate additional (fraudulent) billing for the healthcare provider.

*Improper influence:* healthcare providers use certain labs, physical therapists, medications, second opinions, etc. not for the good of the patient but in return for referral fees. Kickbacks are the inducements by which secondary treatment of the patient is selected, regardless of the quality or costs.

#### SEE ALSO

healthcare fraud; Medicare and Medicaid fraud; kickbacks; pharmaceutical industry; United States; scams.

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## interlocking directorates

MAJOR COMPANIES operate under the control of steep hierarchies, with ultimate vested power, in

principle, in the board of directors. Interlocking directorates occur in situations where a particular person sits on the board or is in the top management of two or more companies. An interlock occurs when an individual serves on the board of directors of two companies (a direct interlock) or when two board members of competing companies serve in the board of a third company (indirect interlock). This concept, in the way it is often used, is considered by some as a cornerstone of western capitalism.

When interlocks occur, there is the potential for cohesiveness, common action, and unified power. This is one of the mechanisms that promotes ever-increasing concentration of the size and power of large corporations. Through interlocking directorates, not only can corporations exert a tremendous amount of power individually, but there is also a potential for coordinated efforts between several corporations since the same individual will sit on several boards representing different corporations. This was common practice as early as the late 1800s and early 1900s.

The use of interlocking directorates is a means of monopolizing the market by giving control over competing companies to the same group of people. This is a collusive practice that strengthens the cohesiveness among well-connected organizations. Compared with cartels, trusts, joint-venture and licensing agreements, interlocking directorates are highly influential, fluid, relatively invisible and hence less open to public scrutiny.

The apparent frequency of these relationships is hardly surprising given the logic of choosing directors with knowledge and experience. The problem arises when an individual simultaneously serves as an officer or director of two competing companies and he/she stumbles across a prime opportunity for collusion, for example, coordination of pricing, marketing, or production plans of the two companies. If such coordination occurs, both the competing corporations and the interlocking director (or officer) could face serious criminal and treble-damage civil liability for price fixing or similar offenses under the Sherman Antitrust Act.

Studies of interlocking directorships go as far back as the Pujo Report (U.S. Congress, 1913), a Congressional investigation into corporate concentration. Control through interlocking directorships is a practice widely recognized by historians of the early 1900s. Investment bankers put representatives

on the corporate boards of corporations they controlled. President Woodrow Wilson campaigned against these “trusts” during 1912 and asked Congress to ban interlocks. The Clayton Act in 1914 prohibited interlocking directorates under all circumstances, regardless of their effect on competition and since then it has been the primary enforcement tool to prevent anti-competitive collusion resulting from interlocking directorates.

Although the Clayton Act filled holes in existing legislation, it too had some loopholes. The prohibition of interlocking directorates specifically dealt with obtaining director positions through stock acquisitions. Unfortunately, this left the possibility of gaining director positions through asset acquisitions for the trusts. While largely unchanged since 1914, the law was updated in 1990 to plug some loopholes and create some safe-harbors.

For example, G. William Domhoff, by analyzing the socio-economic characteristics of leading members of influential institutions from 1932 to 1964, documents interlocking directorships in extensive detail, showing that major banks, corporations, foundations, and insurance companies have boards that share not only clubs and universities, but, in many important cases, are actually made up of many of the same people.

In actuality, corporate governance has become corrupted, with chief executive officers typically appointing the board instead of the reverse. Highly interlocked corporations, such as Verizon Communications International, SunTrust Banks Inc. and J.P. Morgan Chase & Co., are well positioned to exercise a certain measure of influence over the corporate community, and to informally enforce some degree of ideological discipline.

Due to the strong potential for collusion and the emergence of anti-competitive practices and the increase of political leverage that can result from interlocked directorates, they were made illegal in the United States in the early 20th century among competing businesses. Unfortunately, especially in the case of the media, they aren’t currently illegal among non-competing corporations. There’s nothing, for example, to prevent a major corporate advertiser from sitting on the board of a media company it advertises with. Also, the concentration of ownership tends to reduce the diversity of media voices and puts great power in the hands of few companies. Conflicts of interest inevitably interfere with newsgathering.

Interlocking directorates are only one means by which corporations exercise political and economic influence. One example is the military-industrial complex which refers to the circulation of individuals between the government, industry, and the military. The study of interlocking directorates can be essentially classified into four groups according to the emphasis on control, collusion, discretion and/or social embeddedness. Most often, theorists generally see board interlocks as a strategy to reproduce class advantage and further exploit workers and/or consumers. The interlock arrangements benefit the interlocked companies by reducing competition through the sharing of information and the coordination of policies.

In the early 2000s, a great number of board members left seats that required greater time commitments and others dropped positions to avoid interlocks. In some cases, there is no evidence of wrongdoing but the worldwide diffusion of corporate governance, guidelines, and the adoption of the Sarbanes-Oxley Act in the United States led to the need for more independent directors and avoiding potential conflicts of interests.

#### SEE ALSO

board of directors; antitrust; Clayton Antitrust Act; Domhoff, G. William.

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## internet fraud

THE INTERNET OFFERS a global marketplace for consumers and businesses. Internet fraud refers generally to any type of scheme that uses one or more components of the internet—such as chat rooms, e-mail, message boards, or websites—to present fraudulent solicitations to prospective victims, to conduct fraudulent transactions, or to transmit the proceeds of fraud to financial institutions or to others connected with the scheme. Opportunists have begun to recognize the potentials of cyberspace.

The same scams that have been conducted by mail and phone can now be found on the World Wide Web and via e-mail. Many times, it is hard to tell the difference between reputable online sellers and criminals who use the internet to rob people. With the explosive growth of the internet, and e-commerce in particular, online criminals try to present schemes in ways that look, as much as possible, like the goods and services that many legitimate e-commerce merchants offer. In the process, they not only harm consumers and investors, but also undermine consumer confidence in legitimate e-commerce and purchasing products using the internet.

The types of internet fraud are limitless. The most common (in alphabetical order) include: advance fee loans; bogus credit card offers; business opportunities; buyers clubs; charity scams; computer equipment and software; credit card loss protection; credit repair; online escrow tips; general merchandise sales; information/adult services; internet access services; investment scams; job scams; magazine sales; Nigerian money offers; online auctions; prizes and sweepstakes; pyramid and multi-level marketing; scholarship scams; travel fraud; and work-at-home scams.

According to Fraud Watch, in 2002, online auction fraud skyrocketed, making up 90 percent of all reported internet crimes. These schemes, and similar schemes for online retail goods, typically purport to offer high-value items—ranging from Cartier watches to computers to collectibles such as Beanie Babies—that are likely to attract many consumers. These schemes induce their victims to send money for the promised items, but then deliver nothing or only an item far less valuable than what was promised (for example, counterfeit or altered goods).

General merchandise and Nigerian money offers accounted for 10 percent of the internet frauds reported. Computer equipment/software and internet access services, work-at-home plans, information and adult services, travel and vacation scams, advance-fee loan schemes, and prizes and sweepstakes scams rounded out the top 10, each accounting for .1 percent to .5 percent of the most reported internet crimes. Victims were of all age ranges, with 78 percent of the fraud victims between the ages of 20 to 49. California had the most victims, with New York, Texas, Florida, and Pennsylvania all in the top five.

Investment frauds usually fit into one of the following categories: the pump and dump, the pyramid, the “risk-free” fraud, and off-shore frauds. The pump-and-dump scam uses messages posted online that urge readers to buy a stock quickly, or to sell before the price goes down. Often the person will claim to have “inside” information or to use a “foolproof” combination of economic and stock market data to pick stocks.

In reality, they are fraudsters (many of them teenagers) who stand to gain by selling their shares after the stock price is pumped up by gullible investors. Once these fraudsters sell their shares and stop publicizing the stock, the price typically falls and investors lose their money. Fraudsters frequently use this ploy with small, thinly traded companies or penny stocks that are not listed on NASDAQ or Dow Jones, because it is easier to manipulate a stock when there is little or no information available about the company.

For example, in one federal prosecution in Los Angeles, the defendants allegedly purchased, directly and through a third party, a total of 130,000 shares in a bankrupt company, NEI Webworld, Inc., whose assets had been liquidated several months earlier. The defendants then allegedly posted bogus e-mail messages on hundreds of internet bulletin boards, falsely stating that NEI Webworld was going to be taken over by a wireless telecommunications company.

At the time of the defendants’ alleged purchases of NEI Webworld stock, the stock was priced between 9 cents and 13 cents a share. Ultimately, in a single morning of trading, NEI Webworld stock rose in 45 minutes from \$8 per share to a high of \$15-5/16, before falling, within a half hour, to 25 cents per share. The defendants allegedly realized profits of \$362,625. This may not seem like an

enormous amount, but just imagine the potential if this was done several times or with more victims.

### SPAM AND MORE SPAM

“How To Make Big Money From Your Home Computer!!!”: These messages usually arrive via spam e-mail. The promoters send millions of these messages claiming that investors can “turn \$5 into \$60,000” in an extremely short period of time. These schemes typically require the individuals to pay anywhere from \$35 to several hundred dollars or more, but fail to deliver the materials or information that would be needed to make the work-at-home opportunity a potentially viable business. These programs are nothing more than an electronic version of the classic pyramid scheme in which participants attempt to make money solely by recruiting new participants into the program.

The “Risk-Free” fraud also usually arrives via unsolicited e-mails. They offer the customer the opportunity to participate in exotic-sounding investments, such as wireless cable projects, prime bank securities, and eel farms. Absolutely no investment is risk-free, and sometimes the investment products touted do not even exist: They are purely fictional and merely scams. In a federal prosecution in San Diego, California, a major fraudulent scheme used the internet and telemarketing to solicit prospective investors for so-called “general partnerships” involving purported “high-tech” investments, such as an internet shopping mall and internet access providers. The scheme allegedly defrauded more than 3,000 victims nationwide of nearly \$50 million.

Internet frauds are not confined to perpetrators in the United States; many of the scams that exist today originate in other countries. Off-shore frauds were at one time very expensive to commit via the telephone or mail, but with the ever-expanding internet, these frauds are now becoming very cost effective. It is very difficult, if not impossible, for U.S. law enforcement agencies to investigate and prosecute foreign frauds. The Securities and Exchange Commission (SEC) actively investigates allegations of internet investment fraud and, in many cases, has taken quick action to stop scams, but because the frauds can originate outside the United States, there is only so much the SEC can realistically do.

The Internet Fraud Complaint Center (IFCC) is a joint project of the Federal Bureau of Investiga-

tion (FBI) and the National White Collar Crime Center (NWC3). Federal, state, and local law enforcement agencies receive online complaints, analyzing them to identify particular schemes and general crime trends in internet fraud, and compiling and referring potential internet fraud schemes to law enforcement. In addition to FBI and NWC3 personnel, the IFCC includes agents and analysts detailed from the Internal Revenue Service and Postal Inspection Service. In effect, the IFCC provides federal, state, and local law enforcement agencies with a single point of contact for identifying and referring internet fraud schemes for criminal enforcement.

Because criminal fraud schemes on the internet, such as major investment or credit card frauds, can be initiated and concluded in a matter of days or even hours, traditional methods of investigating fraud schemes no longer suffice. By co-locating agents and analysts from the FBI, the NWC3, and other agencies, the IFCC can provide a substantial investigative and analytical resource available on a nationwide basis to law enforcement and regulatory agencies.

### AUCTION SITES

Increasing numbers of people are using internet auction sites like eBay. There are some specific preventive tips to make sure the site is legitimate. If the site does not have any contact information beyond an e-mail address, this may be a suspect site. Legitimate companies will have a physical address and a phone number rather than merely a post-office box. One should understand as much as possible about how the auction works. What obligations are as a buyer and what the seller's obligations are need to be understood before one bids.

Bidders should also find out what action(s) the website or company takes if a problem occurs. If there are no policies, then the site may not be reputable. When bidding on merchandise, one should learn as much about the seller as possible, especially if the only information provided is an e-mail address. Examine feedback about the seller. Potential buyers should not give out any information that is not necessary to complete the transaction.

### SEE ALSO

advance fee scam; cyberstalking; Nigerian 419; direct-mail fraud; wire fraud; scams.

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## Interstate Commerce Act

AFTER THE CIVIL WAR, the United States embarked on a massive railroad-building program. Although often subsidized generously by state and federal governments, railroad companies were private corporations, and regulation was nonexistent.

Each railroad had an initial natural monopoly but eventually they began to intrude onto each other's territory, creating fierce competition with associated special deals and costs that had to be made up in the areas without competition. Quickly, the railroads came to dominate the economic life of the communities they joined, especially those small agricultural towns in farm country previously accessible only by dirt road.

By the 1870s, farmers and others began to object to the excessive economic power of the railroads. Charges abounded of monopolistic practices, influence peddling in the political arena, stock manipulation, rate discrimination—and the reality was that the charges were at least somewhat true. Frustrated by inability to get their crops to market due to railroad manipulation of access to terminals and the availability of freight cars, the farmers organized and demanded government control of railroad abuses.

Their demands for government intervention fell on deaf ears. During the 1870s, the dominant philosophy in all economic matters was *laissez-faire* free enterprise, and governments at all levels were reluctant to interfere with the economy. The presidents and many Congressmen opposed regulation, and when the states attempted to regulate the railroad behemoths, the U.S. Supreme Court overturned their efforts. Worse, the efforts were futile because the state power ended at the state line. Illinois passed the first regulatory legislation in 1871, and southern and midwestern states quickly followed suit.

The railroaders faced a hodgepodge, with laws changing at each state line. Nobody found the situation to be satisfactory. Public demand finally got results years after the first complaints. The railroads generally supported one national regulation as preferable to the mix of state ones; it was more rational and easier to deal with (and manipulate). Railroaders were not happy with the cut-throat competition either.

Not until 1887 did Congress enact the Interstate Commerce Act. The act established the first true federal regulatory agency, the Interstate Commerce Commission (ICC.) The president, with Senatorial consent, appointed the members of this first “Fourth Branch” agency. To control abuse and discrimination by the railroads (and later trucking and other common carriers), the ICC required “reasonable and just,” and published shipping rates as well as no more secret rebates or price discrimination against small markets. The setting of equitable guidelines for railroad operations proved complex—what exactly did “reasonable and just” mean? What exactly constituted a “discriminatory” rate? The theory foundered in the details, and in the lack of clear and unambiguous support by the various administrations, as well as the pressures from the railroads and their political friends.

Further, although the ICC could call witnesses and investigate, it lacked enforcement power and adequate funding. It could advise the railroads that their rates were excessive, but it could not force alteration of those rates or levy fines or other punishments. The ICC's major accomplishments were the establishment of annual reporting requirements by the railroads and a prohibition of railroads setting special rates among themselves, or collusion in rate fixing.

And after the flurry of reform, presidents tended to appoint commissioners sympathetic to the railroads, further weakening the reform. Supreme Court rulings generally weakened the already tenuous commission, necessitating additional legislation over time.

Later legislation enhanced the ICC. The Hepburn Act of 1906 gave the ICC the authority to change “unjust and unreasonable” rates after a formal hearing. The Mann-Elkins Act of 1910 gave the railroads the burden of proving that rates were reasonable. The two acts in combination gave the ICC almost total control over freight rates and, thus, competition.

Over the subsequent decades, the government continued legislating restrictions on the powers of the railroads, imposing an eight-hour day in 1916, even taking over the railroads as a wartime exigency in 1918 before returning them under the Esch-Cummins Transportation Act of 1920. In the pro-business 1920s, the ICC regulated mergers, often forcing the combination of a profitable with an unprofitable route. Railroads, at the time and after, were coming under increasing pressure from cars, buses, and trucks on the growing network of federally subsidized roads. The ICC expanded its scope in 1940 to encompass the other carriers, but regulation of railroads remained primary until, in the 1950s, the ICC realized that the railroads were suffering, and no longer proved a monopoly threat at all. By the 1970s and 1980s, railroads had the freedom they had lost in the 1880s. But they had freedom in the teeth of fierce competition from trucks, airplanes, and other carriers. When deregulation was finished with the 1980 Staggers Act, railroads were close to moribund. By 1995, the ICC was obsolete. Deregulation eliminated its rate-setting authority: the ICC Sunset Act eliminated it in 1995.

The takeover of the ICC by the railroads is an example of the way in which regulatory agencies, intended to protect consumers, become captive of those they were chartered to regulate. After trucking supplanted railroads as the primary common carrier, the commission did come under attack for its favoritism, especially allowing artificially high prices and regulation to protect companies from competition by new entrants. By 1995, deregulation had reduced the power of the ICC, giving way to the Surface Transportation Board within the Department of Transportation.

#### SEE ALSO

oligopoly; antitrust; Sherman Antitrust Act; reform and regulation; Industrial Revolution.

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## investigation techniques

HOW ARE WHITE-COLLAR and corporate crimes discovered? Compared to more traditional, or "street" crimes, the investigation of crimes in the business world is often more difficult and time consuming. This is due, at least in part, to the fact that white-collar and corporate crimes tend to be more complex, may involve multiple offenders and organizations, and may span many years duration before an investigation is performed. A primary difference between white-collar crimes and street crimes is that the latter may be committed with weapons of violence, such as firearms and knives, while the former can be committed with weapons that are not so obvious on the surface, such as through the use of computers, mail, and phone lines. All of these factors make the investigation of white-collar and corporate crimes a challenging endeavor.

Existing research and information on the investigation of white-collar and corporate crimes has generally focused on the broad category of fraud. Fraud may take several forms, and could be classified as either white-collar or corporate crime. Regardless of how fraud is categorized, criminologists and investigators agree that this all-purpose crime occurs most often in organizational settings. As a result, available guidelines and strategies for investigation of white-collar and corporate crimes are most applicable to organizations. Organizations can be victimized by fraud from within, or may also be the targets of scams from outside individuals, such as vendors.

First and foremost, a fraud investigation should have the approval of an organization's management. Much like investigations of street crimes, the goal of white-collar crime investigations is to reveal the truth. Before initiating a fraud investigation, there must be circumstances that suggest fraud has taken place, is taking place, or will take place. This standard is referred to as a "predication of fraud." Such a standard is important for a number of reasons. For example, since conducting an investigation can often be costly, investigators must be reasonably confident that evidence will lead to a guilty individual or individuals. Additionally, because a wrongfully accused individual can have his or reputation tarnished with a charge of fraud, investigators must also be confident that they can accurately identify the correct perpetrator or perpetrators.

Within organizations, investigation of fraud and other white-collar crimes may be performed internally or with the assistance of outside investigators. Exactly who performs the investigation will depend on a number of factors, such as the size and structure of an organization, and whether law enforcement actions are also required. While a variety of methods may be employed during the course of an investigation, one of the most common is the use of interviews. Regardless of who actually performs the investigation of white-collar crime, the methods used can be classified based on the type of evidence obtained.

Four general categories of evidence have been identified. The first of these, testimonial evidence, is collected from individuals that may be directly or indirectly involved in the offense. To obtain testimonial evidence, investigators can use techniques such as interviews, interrogation, and lie detector tests. A second form of evidence collected during the investigation of white-collar crime is documentary evidence. This type of evidence is taken from written and paper sources, but could also include electronic sources such as computers. The goal of obtaining documentary evidence is to link the perpetrator to the offense. To collect documentary evidence, investigators may locate public records, perform audits, analyze financial statements, or conduct computer and other electronic file searches. Physical evidence, the third general category, commonly involves detailed analyses performed by forensic scientists. Much like the collection of physical evidence in street crimes, this type of evidence can include fingerprints, stolen property, or other factors that physically tie an individual or individuals to the offense. Finally, the fourth category of evidence, personal observation, consists of the gathering of information by the investigators. This general category can include such investigative methods as surveillance and other undercover operations. In addition to classifying a white-collar or corporate crime investigation according to the types of evidence sought, an alternative classification approach is to focus on one of the three known elements of fraud: theft, concealment, or conversion. All three elements of fraud can be investigated with strategies known as inquiry methods. The investigator often proceeds by making a determination of which type of evidence will provide the strongest case against the perpetrator. To investigate theft, the general approach used is simply an attempt to catch

the perpetrator in the commission of the act. To investigate concealment, the focus of the investigator can include a variety of sources used to hide white-collar crime. To investigate the third element of fraud, conversion, investigators have the more difficult task of uncovering the ways in which a perpetrator may have spent or otherwise altered illegally obtained funds or information.

#### SEE ALSO

prosecution; Securities and Exchange Commission.

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## investment trust fraud

AN INVESTMENT trust is a company that makes money for its clients by investing their funds in other companies. Normally, the investor will select an investment trust on the basis of the company's specialization, with trust companies often specializing in communication companies, energy producers, or electronic commerce companies. The investment trust manager pools the money provided by various investors and then places the money into one fund. This allows customers the opportunity to invest in a wider range of companies than if they were investing on their own. Risk is also believed to be spread out because the pooled money is divided over several companies.

A final benefit of an investment trust is that investors can begin by investing small amounts, with low charges by the company for investment decisions. This allows individuals who cannot invest thousands of dollars at a time to slowly accrue an investment portfolio.

There is also a trust known as a split capital trust. Under the normal investment trust fund, investors have the opportunity to benefit from the capital growth of the companies invested in, as well as benefit from the dividends paid by the companies. When dealing with split capital trusts, the in-

vestor has the opportunity to choose either income growth or capital growth; a process that leads to two separate classes of investors. Income investors are those who desire to receive dividends throughout the investment process, as well as recover the invested capital at the termination of the trust. Growth investors, forsake the dividends throughout the trust's life, but in exchange expect a percentage of the fund's capital growth at the termination of the trust. In essence, this means that an individual may choose to either receive a yearly dividend from the companies invested in, or they may choose to forsake the yearly dividend in exchange for a percentage of the pooled fund's growth during the life of the trust. The investor then has the option of a safe investment, which will pay out each year in dividends; or they may take part in a risky investment, which pays out profit at the end of the trust. The growth option is considered the riskier choice because if the fund does not grow, then there is no profit to pay out.

The very nature of the investment trust company allows for great potential of misuse or fraud. Because the investments are made in other companies, there is the risk that investments will be based upon personal preference of the fund administrator and not on the basis of potential for growth. Investment trusts companies are run by a board, but the individual investment decisions are left to the discretion of a general manager selected by the board. There are numerous stories of investment trust funds being invested into companies that were riskier than the investment trust would normally have considered, but the manager maintained a personal interest in the growth of the company.

Another scandal involved investment fund managers investing in each other's fund as a means of making the fund appear to be doing better than was actually the case. These activities eventually led to a state where losses were hard to determine, as investment trust companies had to first determine which fund had actually invested in an industry, and which funds were merely invested in other investment trust funds.

Many others have lost money on investment trusts because of bad investments and declines in the stock market. For example, during the height of the technology investing era in the late 1990s, many investment trust companies began investing in computer companies, software companies, and internet start-up ventures. These companies were consid-

ered guaranteed money-making endeavors. However, during 2000, the stock market dropped drastically as the internet industry began to disintegrate. The investment trusts were unable to pay the dividends contracted to customers, as the investment pools of many trusts were entirely devoted to technology companies.

One final fraud involving investment trusts is known as gearing. Gearing refers to the process of borrowing money from one fund to invest in additional shares of another fund. The process of gearing is risky because the investment fund manager runs the risk that the fund for which the borrowed money was invested in may not provide enough profit to repay the borrowed amount. Administrators of investment trust fund companies have admitted in recent years that the problem of gearing is serious enough to warrant extensive regulation by investment trust companies. Following the downturn in the economy in 2001, the stock market crashed and numerous funds that were already in trouble because of over-gearing were discovered all over the world.

Investment fund companies are not new, and they certainly provide a benefit to those who are interested in investing but desire to invest small amounts of money in the beginning. The solution is to ensure that the investment trust company is properly formed and regulates the administration of their funds.

#### SEE ALSO

securities fraud; bond fraud; pension fraud; Securities and Exchange Commission; fiduciary fraud.

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## Investors Overseas Services

INVESTORS OVERSEAS Services (IOS) was the brainchild of Bernie Cornfield, a former social worker turned mutual-fund financier. Cornfield



took advantage of a growing mutual fund trend that began in the 1950s and continued well into the 1960s. Investment in mutual funds was booming, but Cornfield realized that commission fees were way too high, around 8 percent, and that mutual fund companies' expenses were far too much. Determined to find a way around these costs, Cornfield incorporated his IOS business outside the United States and located it in Geneva, Switzerland, while he incorporated his new company's funds in Canada.

Marketing primarily to expatriate U.S. citizens, U.S. servicemen, and foreign nationals (mostly German), Cornfield quickly built up a staff rumored to consist of over 25,000 employees. Offering close door-to-door service different from other mutual funds, Cornfield's IOS was able to accumulate over \$2.5 billion in around 10 years. Growth continued and soon Cornfield began to let his tremendous investment profile get to his head. He began to live ostentatiously and, in one particular instance, he was front cover material for a popular German magazine, dressed in a velvet coat with a cheetah at his feet.

Cornfield's extravagant successes did not last long. By the end of the 1960s, stock markets across the world began to tumble. The IOS' famous Fund of Funds, which was a mutual fund that invested in other mutual funds offered by the IOS, began to suffer as a result of the worldwide financial difficulty. Soon, Cornfield and IOS faced some major trouble. Investors were pulling their money out of the IOS funds at drastic levels, and employees who participated in the stock-option plan withdrew their funds. In order to stay afloat, IOS had to hold a public stock offering.

IOS' offering was one of the largest ever for a European stock market. On the first day, the price of IOS shares jumped drastically, but by the spring of 1970, they had fallen from \$18 to \$12. Then, Cornfield attempted to bolster the price of shares, which he thought was a bargain, by forming a pool and convincing directors of IOS to invest heavily. Personally, he purchased of \$300,000 worth of shares in one particular instance. However, the price continued to fall and slid all the way to \$2.

During a search for help, Cornfield was approached by Robert Vesco, a businessman from New Jersey, who owned a conglomerate called International Controls Corporation (ICC). Vesco promised to cover IOS' losses and got to know other IOS

directors. Cornfield was unable to refuse his offer of assistance.

It was until much later that Cornfield and his fellow IOS directors realized that Vesco was taking money from IOS to cover his expenses at ICC. Upon discovery, which was after he had taken up to \$500 million, Vesco fled with his fortune and lived throughout the years in different Caribbean nations. With the U.S. Securities and Exchange Commission hot on his trail, he attempted to bribe President Richard Nixon for a pardon with a \$200,000 contribution to his campaign, but the scheme was exposed and consequently failed. Allegedly, he became a major force in drug-trafficking in the Caribbean.

Finally, after many years in Cuba, Vesco began to annoy Cuban leader Fidel Castro. He was charged with economic crimes against the government for illegal drug production in August 1976 and he was sentenced to 13 years in jail. His former cohort, Cornfield, was put in jail in Switzerland for 11 months on fraud charges. Cornfield then returned to the United States and lived in Beverly Hills, California, where he died in 1995 (after continuing to live his showy lifestyle during which he dated notorious Hollywood madam Heidi Fleiss).

#### SEE ALSO

securities fraud; Caribbean islands; embezzlement.

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## Iran-Contra Scandal

ON OCTOBER 5, 1986, a U.S. cargo plane was shot down over Nicaragua. Surviving crew member, Eugene Hasenfus, was captured by the Sandinistas, the pro-socialist government forces. Hasenfus's capture began the cover-up that would culminate in one of the most important scandals in American history. The Central Intelligence Agency (CIA),

working with Colonel Oliver North of the National Security Council (NSC), had setup a network of arms dealers, former military officers, foreign businessmen, retired CIA and Defense Department personnel, mercenaries, terrorists, and foreign saboteurs to sell missiles to Iran. These sales were designed to win release of U.S. hostages being held in Lebanon and divert the profits of the arms sales to Nicaraguan Contras, the anti-government forces supported by the Ronald Reagan administration. The Reagan administration diverted these funds because Congress had cut off all aid to the Contras by passing the Boland Amendment in 1982. The amendment was passed following the CIA's mining of Nicaraguan harbors.

The Boland Amendment made it illegal for the CIA to aid the Contras and, in 1984, Boland Amendment II forbade all sectors of the U.S. government from aiding the Contras. By then, the Contras' campaign was run by North, the NSC deputy-director for political-military affairs. North quickly established a top-secret military supply system. Moreover, knowledge, and in some cases direct approval, of the Contra-aid program came from Reagan's White House.

Unfortunately, North was no match for the Iranian negotiators, who were allegedly helping with the release of the American hostages in Lebanon. Each time an American hostage was released, another was captured. Meanwhile, the plan was working: the artificially inflated the prices of the arms sold to the Iranians allowed some of the profits to be diverted to the Contras. The arms sales took place between August 20, 1985 and October 28, 1988, and involved a total of more than 2,000 missiles and spare parts. Of the \$16.1 million in profits, \$3.8 million reached the Contras.

When Hasenfus informed his captors the he was part of a CIA operation, and identified two additional operatives by their codenames, the entire Iran-Contra affair slowly became public knowledge. North and other NSC officials began shredding incriminating documents and falsifying others, attempting to cover-up the scandal. Reagan and Attorney General Edwin Meese went on national television, on November 25, 1986, to reveal the "discovery" of the inter-related Iran-Contra efforts, and to lay as much of the blame on North as possible. An hour later, North was fired and his boss, NSC adviser Admiral John Poindexter resigned. In order to obtain the testimony of North and

Poindexter and others involved, Congress granted them immunity, undermining the ability of independent counsel Lawrence Walsh to prosecute them.

From May 5, 1987 until August 6, 1987, a joint congressional committee heard over 250 hours of testimony from 32 witnesses. No testimony ever linked Reagan directly to the scandal. North's secretary, Fawn Hall, testified to shredding classified documents and smuggling others out of the NSC building. Other Reagan personnel provided details of an endless number of lower-level bureaucrats and shady arms dealers involved in the scandal.

CIA Director William Casey died the day after the hearings began from a brain tumor. North admitted lying to Congress, destroying evidence, operating U.S. initiatives in violation of U.S. law, and participating in a cover-up; he cloaked his defense in patriotism and Reagan's praise of him as a national hero.

North's acceptance of a \$13,800 fence security system as a gift from businessmen who were profiting on the arms sales, was justified as necessary to protect his family from terrorists. The committee ended the hearings after Poindexter's August testimony, and issued a final report on November 17, 1987. The report conferred "ultimate responsibility" on the Reagan White House but stated a "cabal of zealots" therein had "undermined the powers of Congress as a co-equal branch and subverted the Constitution." Eventually 11 defendants were convicted of crimes. Former CIA operative Thomas Clines was the only defendant to receive a prison sentence—for falsifying tax records.

In Walsh's Iran-Contra report, published January 18, 1994, he concluded that both Reagan and Vice-President George H. W. Bush knew about the scandal and participated "or at least acquiesced" in the cover-up, but could find no evidence that either broke the law. The Associated Press noted on March 13, 2002 that many former Iran-Contra figures were given jobs in the George W. Bush administration. North could be last seen in 2004 as a commentator and host on cable news networks.

#### SEE ALSO

North, Oliver; Reagan, Ronald; Bush, George H. W.

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## Ireland

WHITE-COLLAR and corporate crime became enough of a public issue in Ireland in the late 1990s that the Criminal Justice (Theft and Fraud Offenses) Act of 2001 was enacted by the Irish government. The act covers: Money laundering the proceeds of crime; corruption against the European Union; corporate crime liability; computer offenses. It also includes the following areas where the law has been entirely replaced: larceny, forgery, counterfeiting, fraud.

As part of the act, a new era of corporate governance was declared with the establishment of the Office of the Director of Corporate Enforcement (ODCE), headed by Paul Appleby. He reported that the number of auditors' reports of suspected company law offenses more than trebled in 2003 to 1,500, from 399 the previous year. At the same time, the number of complaints from the public and other sources doubled to 448.

As a corporate enforcer, Appleby received close to 2,000 reports of suspected company law crime in 2003. The allegations included failure to keep proper books of account, directors' loans that exceeded limits laid down in company law, and failure to provide information to the Companies' Registration Office (CRO). During the year, the director successfully prosecuted 45 people, who were connected with 17 cases, in the District Court. The review said that 30 of these convictions related to 13 cases of failure to keep proper books of account. Of the remaining four, the court also banned one individual from acting as a company director.

### ORGANIZED AND CORPORATE CRIME

After centuries of poverty, underdevelopment, and emigration, Ireland experienced tremendous economic growth in the 1990s, reaping the benefits of European Union (EU) membership and large foreign investments. By the 1990s, however, Ireland's

underworld had blossomed into a lucrative, internationalized and very violent marketplace. As with many other countries, the links between white-collar, corporate, and organized crime became inexorably entwined.

More opportunities emerged with the end of the Troubles (conflict seeking the fate of Northern Ireland as a British territory). Until then, Ireland's small underworld had been dominated by a select number of crime bosses and their gangs (usually their immediate and extended families), that primarily dealt in small-scale fraud, gambling, prostitution, drug-smuggling, bootlegging, armed robberies; and relatively petty bribery paid to government officials.

After a serious rise in gang and drug activity, unexpected public and official outcries led the gang leadership to flee abroad, while its drug empire was taken apart by rivals, upstart gangs, and corrupt law enforcement. Ireland endowed itself with one of the most effective anti-organized crime set of agencies in Western Europe such as the Criminal Assets Bureau (CAB). In conjunction with international law enforcement agencies, Ireland began to restore its image, which had been tarnished by its reputation as an important cog in international money-laundering.

So effective was law enforcement that a vacuum was left to be filled by a number of international crime syndicates. Many took advantage of this window of opportunity. For example, Nigerian groups in the early 2000s were active in Dublin, the capital, where they introduced crack cocaine. Along with Romanian groups, Nigerians have become important players in a number of fraud (credit card and welfare) and counterfeit schemes (official documents). Irish passports are popular with underworld figures, and readily available as they are often bartered for drugs.

Taking advantage of a crackdown on Dublin's sex industry in 1999, Eastern European gangs got involved in the city's prostitution industry. Using a method pioneered by Chinese people-smugglers, women were brought in on student visas. Once in the country, the women and illegal migrants (from China, Africa, Eastern Europe and Asia) simply disappear. Chinese gangs are also involved in heroin smuggling, and primarily use Irish mules (human carriers) to transport it from British airports.

In spite of this internationalization, organized crime remains dominated by native-born Irish who

invest their massive profits in real estate and businesses in the island country and abroad.

Although part of the United Kingdom, Ulster and Northern Ireland's underground economy are now intrinsically tied to that of the Irish Republic. Loyalist gangs, whose political ideology makes any dealings with the Republic anathema, are known to launder their money in that country's banks, betting shops, and foreign exchange offices.

Northern gangs have also discovered the massive profits to be made in the smuggling of cigarettes and tobacco products, petrol (gas), and counterfeit goods such as pirated CDs and videos, clothes, and alcohol. Although the production, distribution and sale of counterfeit goods is largely in the hands of Northern Irish organized crime groups and paramilitaries, who control the markets where these goods are sold, they have struck-up working relationships with the province's South Asian community that produces much of the counterfeit clothing, as well as with international crime syndicates from Russia, China, and Italy.

#### SEE ALSO

drug trafficking; United Kingdom; organized crime; money laundering.

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## Irving, Clifford (1930–)

**AUTHOR CLIFFORD** Irving perpetrated a literary hoax by pretending that he was helping Howard Hughes (1905-76) write an authorized biography.

The sizeable public interest in Hughes, billionaire adventurer, aviation pioneer and movie mogul, an entrepreneur with deep involvement at the highest political levels of government, was due to his seclusion and eccentric habits. Hughes had not been seen in public nor made any public statement for many years. Irving firmly believed that the reclusive Hughes would not come out of reclusion to refute the fabrication.

Irving approached his publisher, McGraw-Hill, in 1971 with the story that he had a manuscript based on letters and interviews with Hughes, whom he claimed authorized the biography. This literary coup would have resulted in a major bestseller for McGraw-Hill because millions of people wanted to know what had become of Hughes, and why he had withdrawn from public life. Once the documents were signed, with Irving supplying a forged Hughes signature, McGraw-Hill offered him a \$765,000 advance. *Life* magazine, a glossy popular mass-market weekly, also agreed to run the story offering a \$250,000 advance. The Dell Publishing Company offered a \$400,000 advance for paperback rights. Checks payable to Hughes were illegally cashed by Irving's wife Edith.

Irving was inundated with requests for interviews. He played the game with gusto, thoroughly enjoying the celebrity status it brought him. Irving and his researcher and collaborator, Richard Suskind, benefited from a manuscript written by Noah Dietrich, Hughes's right-hand man and accountant, and used it as a basis for their deception, delivering the manuscript in 1971.

However, the ruse came to an end when Hughes made a totally unexpected telephone conference call on January 7, 1972, denouncing Irving's claim. Although Hughes had not been heard from in years, experts verified his voice. Hughes stated he had never met with Irving. The signature and letters that Irving claimed were written by Hughes were declared to be fakes.

Irving finally admitted to the hoax in 1972. He had to return the \$765,000 advance to McGraw-Hill. He was charged with 14 criminal counts: possession of forged documents; intent to defraud; grand larceny for stealing monies from McGraw-Hill; perjury; and conspiracy. His wife Edith and Suskind were convicted for their roles in the scheme. Irving was convicted of fraud and sentenced to two-and-a-half years but served only 17 months.

After his release from prison, Irving wrote many successful books. In 1981, he wrote *The Hoax* that was published in Great Britain. The fascination with the story was emphasized with the offer of a \$500,000 publisher's advance. This was later withdrawn. *The Hoax* explains in great detail how the plot to write the Hughes biography mushroomed beyond Irving's control. The story escalates into a spy thriller involving the international jet set, intrigue at an enormous scale, and the machination of corporate executives. As of early 2004, Irving lived in Mexico and continued to write nonfiction books.

#### SEE ALSO

scams; forgery; art fraud; impersonation.

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## Israel

AS WITH OTHER COUNTRIES, it was not until Israel made the shift from a largely agrarian-pioneer society to an urban-industrial and bureaucratic one that corporate crime and its cousin, organized crime, became an important fact of life. Until then, phenomena such as patronage, personalized and informal business and political relationships were not seen as corrupt; they were the way things were done. Moreover, because Israeli authorities have been preoccupied with national security (since the state's founding in 1948) the issues of official corruption and organized crime were rarely studied or addressed until recently. They were not first-order concerns unless they had a direct impact on national security.

Organized crime came to the fore in the 1970s with the arrival of Jews from the Soviet Republic of Georgia, part of the Soviet Union. Some Georgians brought with them the ways and ethos of the Soviet Union whose economic and political systems

would have ground to a halt without the lubricants of graft. Thus, the Georgians had learned how to take advantage of the state, its property and the avarice of its officials. It was only natural that they would act similarly in Israel.

Part of this new ethos was embodied in the distinct codes and norms of the *vory v zakone* (Thieves Professing the Code). These progeny of 19th-century thieves' guilds thrived and dominated the gulags of the early Soviet period until the end of World War II. Unlike other prisoners, the *vory* consistently refused to work and were steadfast in their unwillingness to cooperate with authorities; a *vor's* reputation was largely based on his ability to withstand the state's harassments and punishments. Although most *vory* were killed, their ways were resurrected in the 1970s and 1980s by a new generation of criminals, a significant number of which were from the Caucasus in Georgia.

In Israel, the Georgians introduced new types of criminal activities, such as currency and official document counterfeiting, corruption of public officials and large-scale frauds, and illegal diamond trafficking. They also improved existing activities such as consumer-goods smuggling (Israel has very high taxes), extortion, and theft. The latter was facilitated by the criminals' presence in many of the country's sea and air ports.

The Georgians didn't survive past the midway point of the 1980s, as many of their leaders either died (naturally or prematurely), fled the country, or were imprisoned. There were to be no second-generation Georgians. Moreover, like their brothers in the Soviet Union, these traditionalists were marginalized by a more violent and entrepreneurial younger generation of native-born Israeli and second-wave Soviet immigration gangs.

The second wave of Soviet Jewish immigration started in the 1980s, when many were escaping from the anti-Semitism and poverty of a crumbling Soviet Empire. As is the case in most migrations, this one brought with it a certain criminal element. The element resembled its predecessors only in terms of its creativity and lack of respect for law enforcement. However, these groups fundamentally differed in use of violence, the newer wave being much more prone to use violent methods to collect debts, extort protection fees, and settle disputes.

At first, the new immigrants clashed with Israeli gangs (primarily made up of Jews from the Middle East). But, the potential profits from drugs and

arms trafficking, prostitution, money laundering, auto theft, and diamonds proved alluring and partnerships were hammered-out. Clashes still occur, especially between Russian and Israeli street gangs, but violence is not good for business as it attracts undo attention from the authorities and the media.

Because the drug trade is a global one, Israeli organized-crime groups have had to develop international links with groups from Turkey, Lebanon, Thailand, Africa, and Latin America, not to mention those from the former Eastern Bloc. From these countries come cocaine, heroin, hashish, marijuana, designer drugs such as Ecstasy, and methamphetamine. Interestingly, cocaine from Latin America comes into the Tel Aviv airport from where it is transported to Beirut, Lebanon.

Israel also has the dual problem of people-trafficking and smuggling. Although they are often used interchangeably, smuggling and trafficking are two different phenomena. Smuggling essentially refers to the illegal transport of a person or persons across an international border, while trafficking entails the use of coercion, deception trickery, and exploitation in the people's recruitment, transport, and harboring.

Most of those trafficked end up as indentured labor working in prostitution or sweat shops. The entire trade in human beings has been facilitated by a number of corrupt officials who have sold visas to the traffickers and smugglers. Corruption of Israeli bureaucracy has become a major concern as evidenced by allegations that Russian mafia leaders, for instance, have generously donated to political parties and campaigns.

Although a lucrative market, Israel remains a very small one. It does, however, constitute a safe haven for certain people as Israel offers a relatively facile investment environment, one which facilitates money-laundering and will not deport its citizens. The Law of Return, whereby any Jewish person can claim Israeli citizenship upon arrival in the country has therefore created a lucrative market in false papers indicating a Jewish background.

#### SEE ALSO

Russia; human trafficking; organized crime.; money laundering.

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## Italy

A DISREGARD for the law is one of the challenges facing Italy today. Evidence suggests that a weak civic sense is one of the causes of this phenomenon. Often, and in many differing contexts and situations, Italians seem to place their own immediate advantage above the common interest. The state is viewed as an antagonist, or even as an enemy, rather than the expression of the common good. This attitude is presumably based in part upon the conviction that the state itself is far from being a law-abiding counterpart. The fact that what belongs to the public sphere is looked upon with skepticism, if not with open contempt, can be attributed to a number of factors.

One is the existence of an incompetent or corrupted central administration (metaphorically expressed by the relatively widespread practice of calling Rome, the capital city where the Italian bureaucratic apparatus reigns, a "whore"). A second factor is the deeply rooted patronage system (the exchange of favors between politicians and the electorate), and a third is the interpenetration between elements of the state apparatus and the world of organized crime. The lack of a strong civic sense and the consequent distance between the individual and the state, are particularly evident in the southernmost areas, traditionally a territory largely neglected by the state. Here, the rhetoric may reach its extreme formulation: nothing and nobody exist outside one's (extended) family.

Another concept, that may help to explain the existence of many areas where the border between legal and illegal activities is blurred, is the perception that the law in Italy has, more often than not, a value which is merely symbolic. In contrast to the

common-law practice typical of the Anglo-Saxon countries, in Italy laws never lose their status as symbolic simply because they are not enforced. Therefore, it may not be entirely surprising that even law-abiding citizens may look skeptically upon legal rules or may treat them as an object for negotiation and compromise rather than as principles to be respected. This anti-state attitude has certainly not been weakened by the fact that the prime minister in the early 2000s, Silvio Berlusconi, was very much involved in finding all possible strategies (including the passing of personalized laws) to avoid the risk of being convicted of breaking a number of his country's laws. This deeply ingrained Italian cultural attitude must be borne in mind when seeking to describe Italian business organizations, organized crime, and the ties between them.

#### ITALIAN WHITE-COLLAR CRIME

Business crime, a term which is considered equivalent to other terms such as economic or white-collar crime, means, in our definition, to deal with violations committed by persons of high social status in the course of pursuing their profession or occupation. From this definition, it follows almost automatically that business crime is, typically, a hidden crime. Business crime is characterized by the presence of a number of factors. First, the technical nature of the crime may impede detection and subsequent prosecution. Second, the relatively high social status of the offender helps him to be "invisible" in the eyes of the judiciary. Many Italians, perhaps even the judges themselves, who see in the offender a member of their own social class, do not see such an offender as a real criminal.

Finally, since such defendants, unlike the perpetrators of street crimes, have access to a private attorney, rather than having to rely upon a public defender, they are far more likely to be acquitted. As a recent investigation based upon a two-year study of criminal trials has shown, the probability of a white-collar criminal gaining acquittal is three times higher than that for a blue-collar defendant. This specificity is not uniquely Italian since it springs out of the more general power relations within society.

In short, statistics about convictions of white-collar criminals are nothing but the tip of an iceberg. Yet, this inability to quantify the extent of white-collar criminality on the basis of convictions

recorded does not prevent a credible picture of business crime and its diffusion within and impact upon Italian society. There is enough empirical evidence from other countries, particularly from large surveys carried out in the United States, showing that corporations, including the most respectable ones, do violate the law. Clearly, there is no reason to think that Italy should represent an exception.

We can gain insight into the behavior of leading managers by looking at the cases of insider trading, one of the few white-collar crimes where quantitative, albeit scarce, data are available. According to CONSOB, the authority controlling the Italian stock market, there is a clear upward trend. In the year 2000, 38 dossiers (inquiries) were sent to the prosecutor's office, twice as many as the previous year. However, not surprisingly, only two persons have been convicted since 1992, the year when this behavior became criminalized.

We may also turn to a case which shows how business crime easily finds its nourishment in association with other partners, such as the public sector and organized crime. In fact, corruption itself can be considered a special type of white-collar crime. A typical case is the criminal association among entrepreneurs, professional criminals, and public servants. In this instance, organized crime is the armed enforcer which guarantees the realization of lucrative illegal economic transactions carried out by entrepreneurs with the complicity of public administrators.

This kind of criminal association, where several criminal typologies are involved, has played a central role in the greatest scandal since World War II, a scandal that unfolded in Italy in the early 1990s. This criminal conspiracy or system was referred to as "Tangentopoli," first in the national and local media, and then in public discourse, a term taking its name from the word *tangente*, indicating the money extorted from or paid by the entrepreneurs to managers, bureaucrats, and political leaders. This scandal involved major corporations as well as members of the parliament, of the public administration, and of the judiciary.

Bettino Craxi, former prime minister, and leader of the Socialist Party (a professional criminal, he was sentenced to many years of imprisonment on charges of fraud and bribery) theorized that bribes were a necessary fuel for the smooth and efficient functioning of society. Socialists were some times called "10-percent men," since it was

they who introduced the principle of taking 10 percent out of every illegal economic transaction.

What the prosecutors discovered was an entire universe of criminal activities, from bribery to extortion, from fraud to murder—probably the largest known number of crimes committed by Italian political and economic elites. A few facts: according to the prosecutor's office in Milan (investigations and trials were carried not only in Milan, but in several other cities and thousands of similar cases were discovered) the economic value of the crimes committed by the politicians alone involved amounts of over \$1 million; one member of parliament (MP) out of three was under investigation; one MP out of four was charged with serious offenses (crimes implying imprisonment). But the big money went abroad. Just one example: approximately \$100 million were held in two Hong Kong banks, the Hong Kong and the Shanghai Banks.

The 2000 figures from this single prosecutor's office furnish the following picture: 3,200 people investigated; 2,575 tried; 577 condemned; 2 people in prison. It should be noted that these figures are a good illustration of the more general case made above, namely, that the very nature of this type of crime reduces the probability of obtaining a reliable measure of its diffusion. The discrepancy between the number of people who were the object of investigation and the number of those who actually went to prison is simply enormous.

If white-collar criminals have always been difficult to detect, prosecute and convict, that is the case to an even greater extent today. Over the past two decades, the campaign of moral consciousness-raising, as well as the public support for aggressive prosecution of white-collar crime which followed the Tangentopoli case, have quickly ebbed. In a general climate of increasing attacks against the Milan judges, accused of not only going into politics but of persecuting the prime minister himself, laws have been recently passed that have made it practically impossible to prosecute him and, more generally, corporations and individual managers for publishing fraudulent balance sheets and other related economic crimes.

These authoritarian trends, severely impinge upon the autonomy of the judiciary and, in particular, the public prosecutors' offices. These officials are now more or less forced to concentrate their attention upon more ordinary criminals and the *de facto* decriminalization of typical economic crimes

is obviously not without consequences. A backlash in terms of general moral apathy, accompanied by the often-repeated cynical remark that "so goes the world" are the most evident negative effects. It is amazing to note that Cesare Romiti, Fiat's former general manager, found guilty of company fraud by the first degree court and sentenced to 18 months in prison a few years ago, is today (in early 2004) the managing director of *Il Corriere della Sera*, Italy's equivalent to the *New York Times*. Neither public blame nor self-criticism seems to be fashionable attitudes in today's Italy.

Moreover, Italy, like all the other European countries, has not escaped the many negative effects of globalization. The liberalization of many activities oriented to facilitate investments and to improve private initiatives, the influence of financial markets in determining priorities of national governments, the decreasing centrality of the state and, last but not least, the apotheosis of the free market as the only instrument credited with ensuring a better and more just world for all, have opened up unexpected opportunities for this type of criminal association. Criminal enterprises have not been slow to avail themselves of the services of off-shore banks and corporations, located where most legal controls are lacking, and the ways through which the internet facilitates money-laundering. In short, if the new configuration of financial and bank markets represents a crucial element for the growth of the legal economy, it plays the same role for the illegal economy. Thanks to the technical resources available today, criminal operators can, with relative ease, transform themselves into legal operators.

## ITALIAN ORGANIZED CRIME

While it is not easy to provide a detailed and quantified assessment of the extent of business crime, for organized crime the picture is less hazy. (For sake of simplicity, the term *mafia* is applied to three other criminal organizations namely, the Camorra, the Sacra Corona Unita, and the N'drangheta. The structures of these criminal organizations, which rule parts of or entire regions, are similar to one another in many respects. There is a hierarchy led by the eldest and/or the elderly. Two fundamental obligations bind the members: an unconditioned loyalty toward the Famiglia, the capital F designating its mixture of affiliations, some based upon blood, some others on salaried labor relations; and an ab-



solute respect for the twofold principle of honor. Upholding honor requires revenge (*vendetta*) in case of offenses directed against a female member (spouse, mother, or sister) of the family, and in case of a betrayal by another family member. All organizations share the notion that the state and its representatives, above all the courts and the police, are the enemy (an enemy with whom is it possible at most to sign a temporary truce).

Above all, one should not forget that the mafia represents a phenomenon which has survived all the political changes and economic transformations that have taken place in Italy in the post-World War II period. In spite of the severe blows inflicted by courageous sectors of the judiciary, the mafia continues to reproduce itself: new bosses arise as fast as old bosses are put in jail.

However, this description, like all generalizations, represents a simplification of a phenomenon continually changing over time, last but not least under the pressure of the increasing number of foreign criminal organizations. Unlike the Mafia, which continues to prevail in some southern regions, organized crime syndicates from Russia, Colombia, Albania, Nigeria, and Turkey have settled in the north, in particular in the most economically developed areas where they don't have to compete with strongly entrenched Italian organizations.

Any society has a number of instruments to make its own citizens more law-abiding. Social control is certainly indispensable but insufficient. The limits of penal policies based upon punishment are well known. There are two sectors, among many others, where much remains to be done: public morality and political commitment. This is a major challenge considering the fact that Italy was led in 2003 by a clique of politicians who seemed to ignore the basic principles of the modern state, among these, generally recognizing the rule of law.

#### SEE ALSO

organized crime; consequences of white-collar crime; corruption; bribery.

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## ITT

NAMED INTERNATIONAL Telephone & Telegraph as a ploy to guarantee confusion with the larger and more established American Telephone & Telegraph (AT&T), ITT embarked on a career of international misdeeds that culminated in bribing the Richard Nixon administration and conspiring to undermine the government of Chile.

Founded by enigmatic Sosthenes Behn as an international equivalent to AT&T, ITT reputedly funneled information from the United States to Nazi Germany as the price of retaining its businesses in Nazi-occupied territory. Although ITT had been accused of harboring spies behind the Iron Curtain throughout the Cold War, any espionage efforts did not prevent communist and socialist governments from expropriating ITT's regional telephone companies.

The real era of ITT diplomacy began when Harold Geneen became chief executive officer in 1959, shortly before Fidel Castro nationalized the Cuban phone company that had been ITT's first business. Determined to shift ITT away from reliance on revenues from outside the United States, Geneen developed a two-fold management philosophy: the company must grow at all costs, and the managers must get results by any means. ITT embarked on a rampage of acquisitions, making it one of the first conglomerates with tight centralized management of companies in dramatically different industries.

By the late 1960s, ITT had 400,000 employees worldwide, employed in industries as diverse as car rental (Avis), hotels (Sheraton), and food production (Continental Bakeries). ITT's May 1970 attempt to acquire the Hartford Insurance Group attracted the interest of the U.S. Department of Justice, which began to investigate whether ITT's piecemeal mergers and ability to direct business to its various subsidiaries constituted a violation of antitrust law.

In June 1971, the antitrust case was abruptly settled, allowing ITT to keep The Hartford at the cost of divesting three smaller and less appealing companies. Seven months later, columnist Jack Anderson printed a memo, attributed to ITT lobbyist Dita Beard, that strongly suggested ITT had gained the settlement by bribing the Nixon administration with \$400,000 to be used to bring the Republican nominating convention to San Diego, California, a personal goal of Nixon.

As flamboyant political networker Beard denied writing the memo, tried to explain away the incriminating portions, and retired to a hospital with a heart attack, the scandal became absorbed into the Watergate hearings that led to Nixon's resignation. The Watergate tapes, released in 1997, include a conversation in which the president discloses a "hush-hush" deal with ITT to aides H.R. Haldeman and John Erlichman.

The \$400,000 for the San Diego convention was not ITT's only foray into buying government cooperation, as Anderson revealed in April 1972. Starting in 1970, ITT siphoned money into Chile to oppose the election of Marxist candidate Salvador Allende. ITT opposed Allende because the company feared, correctly, that he would nationalize ITT's Chilean telephone company. As well as meeting with U.S. government and Central Intelligence Agency (CIA) officials to discuss collaboration in opposing Allende, ITT spent a reported \$1 million on anti-Allende activities. The company was, however, unable to block Allende's election or prevent expropriation of their subsidiary.

How closely ITT was tied to the 1973 coup that assassinated Allende and replaced him with right-wing General Auguste Pinochet is unclear. Writer Anthony Sampson, who had access to ITT's internal documents for his book, *The Sovereign State of ITT*, reports that Latin American public relations specialist Robert Berellez promised ITT leadership that there would be "undercover work" to fuel violence by wrecking the Chilean economy. Sampson refers to a memo sent to ITT Senior Vice-President Edward Gerrity, outlining a plan to bring down Allende. ITT leadership is also rumored to have offered direct funding to the CIA. Berellez and Gerrity denied all rumors in 1973 hearings, as did CIA Director Richard Helms.

In 1978, the Justice Department filed a six-count felony charge alleging that both executives had lied about ITT's Chilean adventures during

their 1973 testimony before a Senate subcommittee on international relations. Helms had earlier been charged with working with ITT to interfere in Chilean politics. The government dismissed the charges in 1979, arguing that prosecuting would involve revealing national secrets.

But, ITT was already in decline. Geneen's 1977 retirement was followed by reversal of his famous strategies, as ITT shed businesses and tried to focus on a few strengths. In 1987, the company's insurance subsidiaries settled claims of fraud and racketeering in Arizona, California, Colorado, Iowa, Minnesota, and Wisconsin. Branch managers at loan offices catering to low-income borrowers had made a practice of "loan packing": including in the cost of the loan various forms of unneeded insurance and club memberships, thus increasing the company's profits while saddling borrowers with interest rates of 24 percent or more. The company was ordered to repay \$2.6 million in Arizona alone.

The loan-packing scheme was arguably consistent with Geneen's management philosophy. In his 1984 best seller, *Managing*, Geneen scolded a company for firing a branch manager who sold the company's product for more than the intended price, pocketed the difference, and, amply self-motivated, created a top-selling store. Said Geneen: "They should have made him president." His company virtually dismantled, Geneen died in November 1997, shortly after publishing a book that lauded measurable results over management theories.

#### SEE ALSO

Anderson, Jack; Nixon, Richard M.; South America; AT&T; military-industrial complex.

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# J

## Japan

THE COUNTRY OF JAPAN has developed the second-largest economy in the world. Yet its industrialization and economic development happened very rapidly, and in a context of previously extended isolationism from the rest of the world. As a result, many of the systems and practices developed in Japan, which were suitable for earlier periods of its development, have been found to be out of step with modern, international business practices. The method of development adopted was one that stressed the cooperation between all members of society (business, people, and government) in ways which can appear to be collusive and corrupt. Together with these practices, are aspects of Japanese society such as the *yakuza* (organized crime) which appear to represent obvious cases of organized crime.

### JAPANESE BUSINESS SYSTEM

Developed in response to the external shock of realizing the outside world was stronger and more advanced, Japan created a system in which all of its constituent parts would work together for the benefit of the whole country, rather than the benefit of individuals. Japan is, by comparison with the region, an ethnically and culturally homogeneous

country. For cultural reasons, Japanese hold themselves to be different from other people and are quite prepared to accept that state policies should benefit Japanese society rather than anyone else. The system of development fell into four stages: import substitution through technological absorption; domestic rivalry and export expansion; outbound foreign direct investment (FDI); and import expansion from Japanese overseas units. In each case, steps were taken to boost local Japanese capabilities and to exclude overseas firms from the domestic market. This is important because it helps to explain the level of self-reliance which overseas competitors consider unfair, and which contravenes many international trade agreements that require nationality to be of no concern in business decisions.

The Japanese system is manifested in the ways in which central and local government contracts are allocated to potential contractors. Much vital information is withheld from outside competitors who feel themselves unfairly treated. The line between maintaining close and cooperative contacts between businesses and illegal collusion is often difficult to distinguish. Further, much of Japanese law remains in a vague and undefined manner such that it requires interpretation by officials or bureaucrats; again, there is opportunity for outsiders to feel unfairly excluded. This exclusion, it is widely believed

in the business community, may be overcome through paying bribes, which is a widespread part of a gift-giving culture. One particularly well-known example of bribery was that of the U.S. aviation manufacturer Lockheed Corporation which, in the 1970s, paid bribes to a number of officials to secure sales; one result of this case was the conviction of former prime minister of Japan, Takeo Tanaka.

An example of business and government working together is in the program of overseas development assistance (ODA) in Asia. In this case, assistance, which tends to focus on resource-rich recipient countries, is designed to benefit Japanese corporations more than the recipients of assistance. There is also evidence that the Japanese government has linked ODA with obtaining support in international forums, for example in buying votes to support its position at the International Whaling Commission.

Japanese companies have become well-known for the loyalty and diligence of their workers, with the Japanese culture among "salary men" involving long hours, often becoming obsessive, and being susceptible to death from overwork and suicide in the event of career failure or bankruptcy. It is also the case that the *machismo* of Japanese society not only prevents women from obtaining high levels of seniority, but also means they can be subject to sexual harassment and the international problem of differential wage levels. These issues have also traveled overseas when Japanese companies have opened international branches and factories. This has led to difficulties with trades (labor) unions and with local people gaining access to executive levels. However, these problems are lessening in impact.

The large international networks established by Japanese corporations and the unity that each manages to obtain from other units means that acts of collusion are quite possible. This includes such activities as transfer pricing and dumping. Transfer pricing involves selling goods between units of the same corporation at non-market prices to avoid taxation, while dumping involves selling goods in foreign markets at below cost or at least lower prices to get rid of them quickly or to undercut competitors.

A number of cases have been brought against Japanese corporations for possible dumping, and these are dealt with through international trade organizations, such as the World Trade Organization. In some cases, allegations appear to have been made for political purposes as a form of retaliation

against Japan's high informal and formal barriers-to-entry that make it difficult and expensive for most foreign corporations to become successful within Japan. There is also evidence of corporate decisions that have contributed to the significant degradation of the Japanese physical environment.

## YAKUZA AND BUSINESS

It is not illegal in itself to be a member of a gang (a *yakuza*), since these have been accepted as parts of society for a long time. However, additional legislation has been provided to regulate *yakuza* activities, such as their re-designation as *boryoku-dan* (violence groups), which led to a great rush by gangs to redefine themselves as legitimate business associations or even religious orders. The *yakuza* have long been involved in a large number of sectors of the economy, notably construction and local politics, although they have subsequently diversified widely into international markets. Profitable activities include protection rackets, prostitution, illegal gambling and extortion.

Much of the proceeds of these crimes have been laundered by investing them in legitimate businesses, which has been an important factor in preventing prosecutions. Another problem in prosecution has been political protection, especially by the "racketeer-friendly right-wing" parties. The *yakuza* are said to work for members of the leading political parties against their own colleagues and to be linked with very senior political figures. They are also responsible for about one quarter of the current (2004) record level of unscrupulous money-lending deals that are, in an economy that has been in a decade-long recession, causing a great deal of distress.

The *yakuza* are organized into a large number of different gangs and make much use of tattoos and rituals to bind members together and lend prestige to their activities. There are estimated to be some 78,000 *yakuza* in Japan, and their samurai-like code of conduct, with its hacking-off of fingers for transgressions and as a sign of membership, is symbolic of 400 years of history. Many have assiduously cultivated links with politicians for mutual gain. The development of the Kansai airport, for example, is believed to have been marred by the extortion that followed the revelation of the routes to be taken by access roads. Gang members used inside knowledge and brought pressure to bear upon residents of



*Miyajima Island in Japan symbolizes the hundreds of years of religious, cultural, and social traditions that continue to influence the conduct of business, government, and organized crime in the homogeneous country.*

houses along the routes to sell their houses, which could then be resold to the government at a profit, after it had been publicly revealed where the roads would be built.

The tolerance for prostitution in Japanese society and the constant demand for (mostly) women to provide the necessary sexual services has provided the *yakuza* with an opportunity to make high profits through controlling the import and exploitation of women from Southeast Asian countries and elsewhere. A gang controlling 10 such women is reportedly able to make one billion yen (approximately \$7 million) annually, with low costs because of the use of intimidation and drugs to control the women. This trade attracts gang organizers from overseas, and there have been instances of murders of gang bosses. It is apparent that collusion with immigration and other officials permits this large-scale trade to continue.

The Japanese economic success story turned somewhat sour at the end of the 1980s and has continued in decline into the 21st century. In 2003, the economy fell back into recession, which was marked by comparatively low levels of consumer demand, business failures and (for Japan) high levels of unemployment. Underlying this recession was the role of banks in making loans to companies

which later were unwilling or unable to repay them (these are non-performing loans or NPLs). Repeated governmental attempts to stimulate the economy, according to Keynesian methods by spending money, have failed because much of the money was directed into needless construction projects, at least in part, according to some reports, because the construction industry was controlled by *yakuza* who were close to government figures.

#### THE POLITICAL COST

Forcing banks with many NPLs to resolve the issue by forcing repayments or bankruptcies would, it is believed, lead to a string of bankruptcies and bank failures that would have too high a political cost attached. Consequently, banks were allowed to continue, and the recession was prolonged perhaps more than necessary. There have been claims that the *yakuza* took a strong role in this situation, not just in causing banks to make loans that would never be repaid, but also in taking over some debts and ensuring their continued existence. Some estimates placed *yakuza* involvement in NPLs as high as 50 percent, while they may have laundered up to \$15 billion of money into legitimate businesses overseas as part of a bid to obtain a global presence.

This has been partly a result of overseas corporations, especially U.S. corporations, buying assets from distressed Japanese corporations and, in some cases with inadequate due process and diligence, later finding they had bought into businesses connected with the *yakuza*.

*Yakuza* operate front businesses known as *kigyo shatei* to hide the real nature of their businesses. Part of the Japanese economic development success resulted from the government-controlled banking system ensuring that Japanese corporations were able to obtain as much funding as they required at low levels of interest. However, the processes of globalization meant that, from about the 1980s onward, many such Japanese corporations were able to obtain better loan rates from international capital markets than from the Japanese banks that, shielded from real competition, were still inefficient in many ways. To cover the sudden lack of demand for their services, banks cast around for new customers and found them, knowingly or not, in the *kigyo shatei*. Many of the *yakuza* companies that benefited from loans at low interest rates had very little intention of ever repaying the money, and anticipated they would never be required to do so.

One example was Susumu Ishii, openly known to be a leading underworld figure who, before his death in 1991, obtained loans from 12 different banking organizations. Further, on the occasions when individuals within banks have endeavored rather bravely to recover the money, more than a dozen have been murdered or otherwise died in mysterious circumstances. Inevitably, there are many concerns about the decision-making processes in the banking system that permits banks to continue lending or avoid calling in their NPLs. However, most *yakuza* operate at a much lower level than this, being more concerned with minor extortion and the control of games of chance such as pachinko machines.

## POLITICAL SYSTEM

The Japanese political system is structured to allow all agencies and organizations to work together, with outsiders effectively prevented from gaining access to power or even to equitable decision-making. This is achieved through an effective formal and informal consensus system in which all relevant parties are consulted to the extent necessary to ensure that they agree with a decision before it is an-

nounced. Japanese organizational culture frowns upon open discord, and so this system has arisen to prevent the loss of face that disagreement could cause. However, it also serves to exclude outsiders and to maintain the opacity of decisions. The political decision-making process led to a period of almost unchallenged rule by the Liberal Democratic Party (LDP) from 1955 onward. The party became almost institutionalized in power and many LDP sympathizers were placed in important organizations at all levels.

## SOCIAL SYSTEMS

Informal networks, consisting of individuals who graduated from the same class or who hail from the same region, also reinforce the system and bind those already inside closer, while outsiders are excluded even more forcibly. With all parts of the system bound together so they move in the same direction, the line between mutual cooperation and illegal collusion becomes increasingly difficult to define. Added to this is the gift-giving culture in Japan in which visits, on nearly all occasions, are accompanied by often expensive gifts. The difference between corporate gift-giving and outright bribery is one which Western corporations, in particular, find difficult to establish and, fearing that they are losing business as a result, have pushed for all such activities to be deemed bribery and hence outlawed in international trade organizations.

In the political context, the system is ripe for collusion and bribery and this seems to have continued for many years on a staggering scale. Those included within decision-making circles are able to obtain privileged information to enable them to make successful bids for government tenders, to obtain scarce resources at favorable rates, and opportunities to negotiate directly with government figures. Certain ministries offer more opportunities for graft than others and assignment to them may be contested fiercely. Even when bribery is not involved, government treatment of the corporate sector is likely to be lenient because of the practice of *amakudari* (or descent from heaven) that occurs with the forced resignation of ministry officials whenever anyone younger obtains a more senior position to them. This system means they must seek employment elsewhere, and it is natural that they will look to the private sector with which they may have been dealing for some time.

The same situation applies to police officers who, similarly poorly paid by national standards, require additional employment once their official service is complete. Many of these forms of behavior are well-known and documented in public life but go unreported in the media because most media organizations are controlled by large corporate interests. Also, Japanese journalists, for cultural reasons that continue to be important, are reluctant to openly criticize establishment figures.

This does not all mean that all government officials or business people are corrupt or that people are generally insensitive to the slurs on the Japanese character that these instances suggest. There are government agencies and regulations to protect the vulnerable and some reformers and activists do manage to make some differences. However, the unified system acts against individuals and against those not part of the government-business system (who can be the same people in their role as consumers).

Meanwhile, the government agency charged with ensuring fair play in business, the Fair Trade Commission (FTC) is considered something of a toothless tiger because of its continued inability to bring to justice many of those against whom allegations have been made. One problem with the operation of the FTC is that it cannot respond to individuals wishing to bring forward complaints but, instead, must wait to investigate them itself before charges can be brought forward. Consequently, various delaying and diversionary tactics have been employed to ensure that cases are not satisfactorily investigated.

The same situation exists with respect to the protection of consumers: A law introduced in 1994 concerning product liability is considered inadequate as a consumer defense. The onus to prove deliberate design or technology misuse is particularly difficult in the area of complex and technologically advanced goods. A comparatively limited number of qualified lawyers in the general population also tends to act against the possibility of successful legal actions being taken against the corporations, which can afford to hire most of them pre-emptively.

#### SEE ALSO

graft; public corruption; Greenpeace; bribery; extortion; organized crime; Lockheed; ethics; Foreign Corrupt Practices Act.

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## Jesilow, Paul (1950–)

PAUL D. JESILOW WAS ONE of the first criminologists to systematically and rigorously explore the nature, causes, and consequences of fraud in the auto repair industry. Along with his colleagues at the University of California, Irvine (UCI), Jesilow also generated a great deal of research on the kinds of crimes committed in the healthcare field.

Jesilow did his undergraduate work in sociology and political science in the school of social sciences at UCI. His graduate work was done in the social ecology program at UCI, where he received his Ph.D. in 1982. While engaged in coursework, he also worked in a juvenile correction facility and in an educational opportunity program at UCI. His dissertation involved an examination of fraud in the automobile repair industry.

Jesilow has co-authored five books, including *In the Same Voice: Women and Men in Law Enforcement*, *Doing Justice in the People's Court*, *Prescription for Profit: How Doctors Defraud Medicaid*, *White-Collar Crime*, and *Myths that Cause Crime*. The last of these books won the Academy of Criminal Justice Sciences' outstanding book award shortly after it was published.

In the area of white-collar crime, Jesilow worked with his UCI colleagues to expand understanding about a number of different types of workplace offenses. His work on crime in the medical field and police misconduct is especially noteworthy. In medical-crime research, Jesilow has conducted several different studies covering different aspects of the problem. One study considered how the offenses are detected and investigated. Another study examined how prosecutors adjudicated cases involving doctors, while another looked at how medical programs in different countries perpetuated or prevented fraud. He has published his medical-crime research in the *Journal of the American Medical Association*, among others. This research eventually culminated in the *Prescription for Profit* book.

Jesilow's latest interest in white-collar crime has expanded to include research on police misconduct. Combining his interests in policing research with his ability to do public attitude surveys, Jesilow examined the effect that police misconduct has on opinions about the police.

#### SEE ALSO

automobile; police corruption; healthcare fraud; Pontell, Henry N.; Geis, Gilbert.

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## Jett, Joseph (1958–)

JOSEPH JETT WAS dismissed by the prestigious Wall Street firm Kidder Peabody in April 1994, accused of fraudulently booking \$339 million in phony profits on bond trades in his position at the Kidder bond desk. With so many cases of rogue traders bringing down financial institutions, both on Wall Street and internationally, it was not hard

to believe that the case of Jett at Kidder Peabody fit into the familiar pattern.

But Jett and some former colleagues insist that his case was different. In fact, they say, Jett, one of the few African-American traders on Wall Street, was being used as a scapegoat for larger problems at Kidder. They point out that Jett's superiors were aware of his trades, strategies, and profits, and not only allowed it, but rewarded his behavior in an effort to breed star traders, and window dress Kidder's balance sheet for Kidder's new owners at General Electric (GE).

As Saul Hensel of the *New York Times* states it, the central question is: "Can Jett be guilty of fraud if he hid nothing, falsified no records and was subject to several levels of oversight?" Jett and his colleagues were tasked with trying to profit on arcane trades which exploited the price differences between regular government bonds and zero-coupon bonds. Both sides agreed that more than half of the profits booked by Jett were not legitimate profits, but appeared on Kidder's computer screens due to a glitch in a complicated proprietary program that processed the stripping and reconstituting of these trades. Because of this glitch, the further out Jett set the settlement dates for these trades, the greater the profit recorded.

"By the end of 1993, Jett was made managing director, named man of the year, and awarded \$9 million in bonuses on \$150 million of reported trading profits," writes Hensel. With profits rolling in, it was easy for Kidder managers to fail to question how it all worked. And it was even easier to avoid embarrassment later by blaming the fiasco on one rogue trader, rather than address real flaws in Kidder's systems and oversight policies. As at least one trader testified at the Securities and Exchange Commission (SEC) hearing, more than one accountant questioned at the time had reassured senior management that the trades were real, not just paper transactions. Kidder's own internal auditors spent 400 hours reviewing Jett's zero-coupon desk in August and September 1993, but were apparently unable to detect the problem.

Then in the late fall of 1993, GE ordered Kidder to cut back on its bond holdings, and to comply with the order. Jett actually did engage in a number of paper transactions for the sole purpose of meeting the letter of the new balance sheet restrictions. While the SEC and Kidder asserted that this trading was an attempt by Jett to hide his fraudulent



scheme, Jett said his superiors at Kidder ordered him to engage in the trading to deceive GE. Still, in January 1994, Jett's reported profits doubled, triggering another internal investigation by Kidder accountants, who finally figured out how their own systems were booking profits on the forward reconstitutions.

After a former SEC enforcement chief brought in by Kidder as an outside investigator accused Jett of deliberate manipulation of the system, GE officially blamed Jett for a \$350 million charge against earnings and Jett was dismissed. GE ultimately sold Kidder for \$600 million. In securities litigation filed by GE shareholders against Kidder, Kidder officers, and Jett and his supervisor, the court denied the defendants motion to dismiss, finding that the pattern of conduct alleged, if proven at trial, met the legal elements of fraud. The case remained in the courts in 2003.

#### SEE ALSO

Kidder, Peabody; bond fraud; securities fraud; Securities and Exchange Commission.

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## Johns-Manville

GREEK GEOGRAPHER Strabo and the Roman naturalist Pliny the Elder both noted that slaves weaving asbestos into cloth often developed a fatal sickness in the lungs. They were among the first to identify asbestosis, a lung disease caused by inhaling the fine fibers and particles of asbestos.

Johns-Manville, one of the modern companies using asbestos, began in 1858 as the H. W. Johns Manufacturing Company, founded on the principal use of asbestos as a fire-resistant roofing material. In 1901, the company added new asbestos products, including asbestos cement.

By the early 1930s, asbestos workers stricken with asbestosis were bringing damage suits against Johns-Manville, now the largest asbestos manufacturer in the country, and against other leading asbestos manufacturers. These manufacturers created a cover-up of the asbestos hazard that continued for more than 40 years. In 1933, Lewis Herold Brown, president of Johns-Manville, informed the company's board of directors of 11 pending lawsuits brought by employees who had developed asbestosis while working at the company's plant in Manville, New Jersey. He said that the cases could be settled out of court, provided that the attorney for the plaintiffs could be persuaded not to bring any more cases against the company.

Over the next two decades, the cover-up continued. Memos and other written evidence revealed that Johns-Manville did not inform its employees when their chest X-rays showed they had developed asbestosis. In a 1952 symposium, the seventh one held at Saranac Laboratory, doctors informed the participants, including asbestos manufacturers, that medical evidence implicated asbestos as a powerful producer of lung cancer. The proceedings of the six other meetings had been published, but the proceedings of the seventh were not. Very little information about asbestos causing cancer found its way into the press for another decade.

The asbestos cover-up might have continued indefinitely, but in the 1960s, two developments in law and medicine exposed the asbestos manufacturers. In 1962 and 1963, Dr. Irving J. Selikoff, director of the Mount Sinai School of Medicine's Environmental Sciences Laboratory in New York City and two of his colleagues definitively linked industrial exposure to asbestos to extreme health hazards like cancer. And in 1965, the American Law Foundation defined tort law to make sellers of dangerous products liable to users and consumers unless they put adequate warning labels on their products.

In 1971, Ward Stephenson, a Texas trial lawyer, brought the first asbestos product liability lawsuit, and this case opened the way for other asbestos lawsuits. During the next decade, people filed about 15,000 lawsuits against Johns-Manville, Raybestos-Manhattan, and a dozen other asbestos insulation manufacturers. During these suits, hundreds of documents furnished overwhelming proof that these companies had covered up their knowledge of the hazards of asbestos. Juries all over the country awarded large compensatory damages to diseased

asbestos workers and the survivors of workers who had died of asbestos disease. During 1981 and the first half of 1982, juries in 10 different cases found Manville liable for punitive damages worth more than \$6 million. The company and its insurance carriers had already settled some 2,000 asbestos-disease cases out of court for tens of millions of dollars.

In August 1982, Manville, a corporation with assets of more than \$2 billion, filed for protection under Chapter 11 of the Federal Bankruptcy Code, claiming it had been unfairly drained of assets by thousands of unwarranted lawsuits. During the next six-and-a-half years, while the case languished in the courts, Manville did not have to pay anything to the victims. When the final bankruptcy plan was approved, it only compensated 100,000 asbestos disease victims.

#### SEE ALSO

asbestos; employee safety; workplace deaths; unsafe products; Owens Corning.

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## Johnson, Lyndon B. (1908–1973)

THE FIRST ALLEGATION of Lyndon Baines Johnson (LBJ) exploiting his position in the government to benefit his personal business fortune came about while he was vice president, and such allegations persisted until he won the 1964 presidential election. Johnson appeared unable to separate his business work from his political career, and this greatly influenced people's perceptions of him as being a Texas "wheeler-dealer."

His administration was tainted by a past littered with claims of corruption. Most notorious was his victory over Coke Stevenson for the Texas Demo-

cratic Senate nomination in 1948, when he won by a mere 87 votes, and was widely believed to have "stuffed" Texas ballot boxes. In addition to allegations of political corruption, he had accumulated a multi-million dollar fortune through his LBJ Corporation and other business ventures, that raised allegations that he used his political influences to gain unfair business contracts for himself and his friends.

Business dealings caused LBJ the most problems, beginning in 1962 with the Billie Sol Estes scandal. A later scandal involving Johnson's protégé, Bobby Baker, would lead to more public scrutiny. The Baker affair helped fuel the bitter rivalry that Johnson had with Robert Kennedy, who was the attorney general during the John F. Kennedy administration in which Johnson served as vice president.

#### BILLIE SOL ESTES

The Billie Sol Estes scandal emerged in the summer of 1962 when Johnson was still Kennedy's vice president. Estes was a businessman from Pecos, Texas, who had established a lucrative business in agricultural products by mortgaging non-existent farm gear. He also created an illegal cotton-allotment business that eventually resulted in the dismissal of several members of the government's Department of Agriculture (DOA). With the help of government connections, Estes established his cotton business, and it became evident that such a deal would not have been possible without having some major influence within the government. This influence was immediately linked to Johnson. Estes was a major financial contributor to the Democratic Party and had been a major contributor to Johnson's many campaigns for the Senate and as vice president. The link to Johnson appeared strong.

Estes was arrested in March 1962 by the Federal Bureau of Investigation (FBI), charged with fraud and theft. In addition to those charges, the death of Henry Marshall, an official from DOA, cast further suspicion over Estes's affairs. Marshall was sent to Texas to investigate Estes's business deals. On June 3, 1961, Marshall was found dead, his body covered in bruises and shot five times. A bolt-action shotgun was found next to him and his death was ruled a suicide. Some observers considered this a bizarre ruling since a bolt-action shotgun would have to be pumped once before each shot was fired (obviously,

one would think Marshall could not have pumped the shotgun after shooting himself with the first shot.)

Estes went to jail from 1965 until 1971, and again in 1979 until 1984, but never discussed his affairs and never disclosed any ties to Johnson. An FBI inquiry into the Estes case also revealed nothing that would incriminate Johnson. However, in 1984, upon his release from prison, Estes revealed allegations to a Robertson County Grand Jury in Texas that tied Johnson to not only the Marshall murder, but also seven other murders, including Kennedy's assassination.

Estes claimed that he had given Johnson millions of dollars in order to guarantee his unethical cotton business. When Marshall was sent to Texas to investigate, Estes claimed that LBJ contracted a man named Malcolm Wallace to kill Marshall. With the assistance of attorney Douglas Caddy, Estes tried to gain the protection of immunity from the Justice Department before further discussing these allegations in greater detail. Before any agreements could be reached, Estes decided against disclosing and refused any further information.

## BOBBY BAKER

While Johnson was still dealing with the Estes scandal, another was uncovered involving the man whom Johnson referred to as a son, his protégé, Robert "Bobby" Baker. Baker was one of his top aides when Johnson was a Senator, and he became the secretary to the Senate majority leader by 1963. Baker was known as another wheeler-dealer because he had amassed a million-dollar fortune, which drew suspicions because he had always worked for the government for a modest salary.

Baker had, indeed, become entangled in many illegal deals, and his scandal in 1963 could have caused serious damage to not only Johnson, but also to Kennedy. In autumn 1963, Delaware Senator John Williams began to investigate Baker's suspicious business deals. On October 7, 1963, Baker resigned his position, hoping that would put the matter to rest and relieve suspicions of Johnson. However, his resignation did not save Johnson from claims of corruption.

The first issue tying Johnson to Baker was the claim by Dan Reynolds, a businessman from Maryland, that Baker and Walter Jenkins, another of Johnson's aides, had demanded him to pay Johnson

kickbacks after LBJ purchased two life insurance policies from Reynolds. Furthermore, Reynolds claimed that he was pressured to buy advertising space on LBJ's television station in Texas, which was of no use to him since he lived in Maryland. Baker also received a nice commission on the sale of the life insurance policies while Johnson received an expensive hi-fi system from Reynolds, presumably as a kickback, which Johnson later claimed he thought was a present from Baker.

Johnson found himself in the heart of the Baker scandal when it was revealed that the life insurance policies had been sold to the LBJ Corporation with the guarantee that Johnson was a major employee. This contradicted Johnson's claims that his wife, Lady Bird, was in charge of handling all of the business's affairs; otherwise, Johnson could be accused of having conflicts of interests between his business deals and his government role. Unfortunately for Johnson, Baker's involvement in disreputable dealings was not confined solely to the insurance policy claim.

Baker posed such a great risk because he had known ties to gangsters, including the prominent, alleged mobster Sam Giancana. Baker, along with Giancana and organized-crime leaders Ed and Louis Levensen, had acquired the rights to expand Intercontinental Hotel Corporations to the Caribbean. This meant that they would be running illegal casinos throughout the Caribbean.

When rumors of this ploy reached the ears of the White House, Robert Kennedy had the FBI investigate Baker's dealings. After putting immense FBI pressure on Giancana, the gangster backed-off on the casino venture, but not before drawing more agitation from both Kennedys, who were becoming irritated by the constant allegations surrounding the vice president.

## EMBROILED IN CONTROVERSY

Baker's illegal ties continued, as he was also an influential member of the Serve-U-Corporation, a company accused of strong-arming rival businesses into giving kickbacks. These various affairs portrayed Baker as an influence peddler who made his fortune by pushing government officials to give business contracts to his friends. Along with these ventures, Baker also found himself embroiled in more controversy when it was revealed that he had introduced John Kennedy to an attractive East German

prostitute, Ellen Rometsch. Biographers have since discovered Kennedy and Rometsch probably carried out an affair with the president unaware that she had communist ties. When Robert Kennedy found out about Rometsch, he immediately had her and her husband deported to Europe before the relationship was publicly exposed. Had it been revealed to the public, the president would have been unlikely to survive the scandal.

Baker proved to be a major blemish for Johnson's image, which caused great tension between Johnson and the Kennedy administration. To make the situation worse for Johnson, it was widely known that he and Robert Kennedy were at odds. There were rumors circulating that Johnson would be dropped from the 1964 ticket and replaced by Robert Kennedy. This was not hard for LBJ to imagine, as he knew that the 1968 Democratic ticket would fall to either him or Robert Kennedy, and he believed that this would serve as a way to the top Democratic slot. However, the notion that the president intended to drop Johnson as his vice president is unlikely. Kennedy was fully aware that he needed Johnson in order to appease southern voters and without him he would struggle to win those votes.

#### SECRET RUMORS

When Johnson became president on November 22, 1963, following the assassination of Kennedy, his ties to the Baker scandal followed him to the White House. Johnson believed that Robert Kennedy was secretly circulating rumors linking LBJ to Baker in order to destroy Johnson's image. However, biographers show Robert Kennedy did his utmost to protect Johnson from the scandal.

Since it was Kennedy who was in charge of the investigation into the Baker situation, he could have inflicted serious damage to Johnson's character image and career. Instead, Kennedy reported that while Johnson may have had some unsavory connections with Baker, Johnson did nothing that was illegal. The close connections to Baker thus failed to significantly stain the reputation of Johnson's administration. Baker eventually served 18 months in prison in 1971, as a result of his illegal business deals.

Considering the nation was reeling from Kennedy's assassination and needed Johnson in the best light, inquiries died down after Johnson became president. Connections involving LBJ's role in

the Kennedy assassination have produced many conspiracy theories, but nothing more.

Johnson was never found guilty of any wrongdoing in any of the scandalous allegations brought against him, although his suspect dealings and business relationships have forever cast suspicions. Johnson won the presidential election in 1964, but refused to run for re-election in 1968 following mounting death tolls from the war in Vietnam and domestic, social revolt.

#### SEE ALSO

Kennedy, Robert F.; elite crime; corruption.

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## juries and awards

MULTIMILLION DOLLAR awards for damages granted by juries have garnered sensationalist headlines in the past decades. Usually resulting from product liability, workplace injury, and medical malpractice suits launched by individuals against corporations, these cases have cast much negative light on harmful business practices in the United States.

Lobbyists for corporations and allied politicians claim that juries are systematically biased toward the plaintiffs and unfairly award huge monetary damages solely to penalize corporate America. They argue further that such legal restrictions have affected the competitiveness of American business.

The most exhaustive empirical research to date, however, has demonstrated that there is no evidence of systematic jury bias nor that monetary damages awarded to plaintiffs has decreased the profitability of American business. Indeed, there is a strong case

to be made, as Stephen Daniels and Joanne Martin contend, that "Punitive damages provide the only practical means of sanctioning large and flourishing economic actors in the face of weak administrative controls and the limits of criminal justice." An historical overview of juries and awards illustrates, moreover, that changing conceptions of liability for legal wrongdoings and monetary damages awarded by juries reflect shifting social and political attitudes and practices in society at large.

Civil cases involving juries and monetary damages fall under the general rubric of tort law, the law of civil wrongs. Tort law encompasses the legal concepts of liability and negligence. Liability can generally be defined as accountability and responsibility to other persons. Negligence involves a notion of failing to take care where it was reasonable to assume that injury would be caused. Both legal infractions are enforceable by civil and, in some cases, criminal sanctions. Under liability rules, plaintiffs usually only have to show that they were harmed by the defendant's conduct. Negligence laws are stricter and usually require plaintiffs to prove "unreasonable conduct" on the defendant's part.

Civil juries may award compulsory damages, that is, compensation for money, wages, property or emotional suffering lost due to liability or negligence on the part of the accused; and punitive damages, an extra award that penalizes the accused party in an effort to deter future illegal actions. The concepts of liability, negligence, and tort law, in general, therefore are highly ambiguous and inexact. What exactly constitutes accountability and responsibility is a question that historically has been decided by the context of specific political, legislative, and judicial decisions.

## HISTORY OF ACCOUNTABILITY

The concept of liability and negligence for which plaintiffs could sue businesses for damages was narrowly defined until the 20th century. An individualist ethic in line with the ideology of free-market capitalism held sway in legal thinking. This ethic ran counter to the idea that corporate entities should be held liable for negligence and other injuries, and be required to pay compensation for individuals harmed under their auspices.

Thus, in the case of workers injured on the job in the 19th century, it was far more likely that courts would look for culpability among individu-

als (the injured worker or another employee) rather than the company itself.

The doctrine of contributory negligence also dominated legal discourse during this epoch. It held that X could not sue Y if X was partially responsible for an act of negligence. The markedly pro-business ideology of individualism was dominant at the highest levels of the judiciary. In 1873, a member of the New Hampshire Supreme Court characterized the idea of punitive damages in tort cases as a "monstrous heresy." Punitive damages were all but eliminated from tort cases brought against corporations after the Civil War, and 20th century notions of damages based on emotional distress were scarcely considered.

As a result, employees injured at the workplace or consumers harmed by products were frequently unsuccessful in suits against corporations. Lawrence Friedman reports that less than half the already limited number of cases against corporations in New York in 1910 were won by the plaintiff. Sometimes, other individuals could be found liable in such cases, but rarely corporate entities.

One famous case aptly demonstrates the limited concept of employer liability. In 1911, a fire at the Triangle Shirtwaist Factory in New York City killed 146 workers, mostly young immigrant women. The company was found to have committed numerous safety violations, yet a jury acquitted all the company owners from severe charges. Wrongful deaths suits settled out of court by family members resulted in the employers paying a paltry \$75 for each of the 23 plaintiffs.

The nature of the jury system also played a role in limiting notions of liability. The relatively broad powers of the jury in the 18th century was superseded in the 19th century by the growing power of judges who adhered rigorously to the individualist ethic. Moreover, until the 1960s, jury members in state and federal courts were chosen from among people suggested by prominent civic or political leaders. The result was that juries were highly unrepresentative of the population at large and were composed of largely middle- and upper-class, white men who, it can be argued, were much less likely to find corporations at fault.

Throughout the late 19th and early 20th centuries, as the population expanded and the economy became more complex and interconnected, larger social and judicial changes slowly began to alter the doctrine of individual responsibility in

favor of increased liability on the part of businesses. Much of this reform thrust originated from the skyrocketing growth in accidents in the increasingly industrial workplace of the early 20th century. In 1900, for instance, there were 2 million injuries and 35,000 deaths which occurred in the workplace. In 1907, 3,000 coal miners died in accidents across the country; in the same year, over 4,500 railroad workers lost their lives.

While the vast majority of those injured and the families of those killed were never compensated by employers, there was an increasing recognition that a modern, progressive economy required an expanded concept of liability. *MacPherson v. Buick Motor Company* (1916) and *Escola v. Coca Cola Bottling Company of Fresno* (1944) were both precedent-setting cases that witnessed injured persons successfully suing corporations and receiving damages. Reflecting a related trend, state governments also began to establish the first rudimentary elements of workers' compensation to deal with workplace injuries and deaths.

### 1960s REVOLUTION

In the 1960s, a veritable tort revolution occurred. Once again, legislative and court decisions reflected shifting social and political attitudes. Stricter rules for companies, wider definitions of product liability, and increasing numbers of criminal charges against corporate officers marked this era. All states expanded their concepts of negligence and liability and a definite trend toward increased monetary amounts can be discerned in court and state-agency awarded damages. The first settlement over \$1 million was awarded by a jury in 1962.

Medical malpractice suits became more and more common in these years as the public increasingly sought new treatments, as medical techniques became more complex, and as the medical profession itself grew enormously. The introduction of more stringent safety laws and regulations, the rise of consumer protection agencies at the government level, and consumer advocacy groups in society at large contributed to these shifts, as did the general political climate which witnessed large-scale social movements and increasingly liberal social attitudes.

Legislative changes to jury composition in the late 1960s meant a shift toward a more representative section of the population who were willing to find verdicts against corporate entities. Shifting

ideas of social, economic, and environmental justice had therefore altered the social and political context of law by the 1970s.

Highly publicized product liability and workplace injury cases against large corporations, some of which were mass-action suits composed of numerous plaintiffs, blossomed in the 1970s. The first lawsuit related to asbestos poisoning, for example, was filed in 1966 in Texas by Claude Tomplait against 11 manufacturers of insulation products containing asbestos, including Johns-Manville, Fibreboard, and Owens Corning Fiberglass. Asbestos was found to be a highly toxic substance with often deadly consequences for workers who handled it. Yet Tomplait, who suffered from asbestosis, lost the case. A jury verdict found in favor of the defendants. The same law firm who handled this case, however, proceeded with another suit on behalf of Tomplait's co-worker, Clarence Borel.

This time, a jury returned a guilty verdict and granted \$79,436.24 to the plaintiff. By the mid-1980s, claims against asbestos manufacturers had been launched by 30,000 individuals. These long-running cases have led to actual damages in the millions and punitive damages in the billions, although the mass declaration of bankruptcy by many defendants has considerably decreased the amount of damages actually paid. Punitive damages have been awarded on the basis that companies were aware of the health risks, but refused to put in place precautions. One lawyer uncovered a document from a company executive in the asbestos industry that said in part, "if you enjoyed the good life while working with asbestos products why not die from it?"

### CONSUMER ADVOCACY

The majority of cases involving claims for damage have originated in product liability suits. Pioneering consumer advocate, Ralph Nader, was instrumental in encouraging a series of precedent-setting actions against Ford Motor Company in the 1970s. A faulty gas tank in one of the company's most popular models, the Pinto, was found to explode in certain kinds of rear-end accidents. While the company was aware of the potential threat from the launch of the model in 1969, they found the \$11 cost of replacing the gas tanks with safer parts too expensive.

Only in 1977, did they begin to make the necessary alterations to adequately protect the gas tanks from exploding. A number of successful lawsuits

were launched and substantial jury awarded damages were granted as a result of the estimated 500 deaths attributable to the Pinto's design flaw. Ford was initially confident that juries would find the drivers liable for the accidents and opted to fight the cases in court. However, the first few cases resulted in multimillion-dollar awards against the company. "We'll never go to a jury again," Ford spokesperson Al Stechter said in 1977. "Not in a fire case. Juries are just too sentimental. They see those charred remains and forget the evidence. No sir, we'll settle." Consequently, Ford settled the remainder of cases out of court.

### ROBIN HOOD JURIES

Nevertheless, the tort revolution would be relatively short lived. In the late 1970s and 1980s, tort reform lobby groups, bankrolled by major businesses, predominantly in the insurance industry, undertook a concerted legislative lobby campaign to scale back expanded notions of industry liability. They widely publicized, in the words of Daniels and Martin, that the "system [had] run amok with skyrocketing awards ... " Empirical studies have clearly demonstrated, however, that the "frequency of claims, lawsuits filed, trials held, jury verdicts, and jury behavior" has not supported the case for tort reform. There is little data to back up the claim that juries are systematically pro-plaintiff, anti-business, and modern-day Robin Hoods.

A study by the National Center for State Courts found the win rate in civil jury tort trials with business defendants to be 52 percent; other studies of particular states found win rates to be as high as 72 percent and as low as 50 percent. In an exhaustive study of 378,000 state tort cases in 1990-91, the Department of Justice found that three out of four tort cases were settled out of court; only 3 percent went to trial and the plaintiffs won about half the cases.

A few high-profile cases of multimillion dollar awards has also masked the average award which tends to be modest. As Kenneth Jost has shown, plaintiffs "do not regularly win large amounts across all types of cases." In a study of 28 tort cases and eight contract cases, Valerie Hans found the median award was \$115,000 and the mean award close to \$700,000 due to five awards of more than \$1 million. Other empirical studies similarly demonstrate modest median awards with the large majority re-

sulting from compensatory damages. Moreover, punitive damages are rarely awarded. Judicial review of jury-awarded damages tends to reduce rather than increase awards, especially for punitive damages. The success rate of plaintiffs and the monetary value of awards has varied depending on the type of case, the nature of the injuries sustained, the state in which the case was tried, local settlement practices, and the particular mix of cases going to trial. Indeed, a Harvard Medical School malpractice study highlighted the great disparity between injuries suffered and claims or lawsuits filed. No overall trend toward massive awards granted by juries can be discerned across the array of evidence.

While largely unsuccessful at the federal level, many states, according to Valerie Hans, "have changed their tort systems, imposing new restrictions on the civil jury, including modification of liability rules and limits on monetary awards." Judicial decisions in the 1970s and 1980s would gradually weaken the extent of liability law. The Supreme Court gave judges greater control over which expert witnesses could testify, reduced the role of juries in patent cases, and approved restrictions on jury discretion.

Once again, it is clear that concepts of liability by corporate bodies, and the power of juries to regulate business conduct by awarding damages have been shaped by the shifting balance of political forces and social attitudes in the particular context of the 1980s and 1990s.

### SEE ALSO

corporate criminal liability; *caveat emptor*; product deficiencies; Nader, Ralph; consumer deaths; asbestos; medical malpractice.

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## Justice, Department of

THE U.S. Department of Justice (DOJ) is a cabinet department in the United States government that enforces the law and defends the interests of the United States according to the law, ensuring fair and impartial administration of justice for all Americans. The Department of Justice is administered by the U.S. attorney general, one of the original members of the president's cabinet.

The office of attorney general is older than the Department of Justice which the attorneys general have headed since 1870. The Judiciary Act of 1789 created the office of attorney general, providing for the appointment of "a meet person, learned in the law, to act as Attorney-General for the United States." The act stipulated that the duties of the attorney general were to prosecute and conduct all suits in the Supreme Court concerning the United States, and to give his advice and opinion upon questions of law when the president of the United States required it or when the heads of any of the departments required it.

The 1789 act did not make the attorney general a member of the presidential cabinet, but President George Washington decided that he needed the first attorney general of the United States, Edmund Randolph, to attend all of the cabinet meetings because of the numerous legal matters that he and his cabinet discussed. Since the attorney general continued to attend the cabinet meetings in the administrations of John Adams and Thomas Jefferson and beyond, the office became recognized as a cabinet post. The attorney general is directly appointed by the president and is confirmed by the Senate. From 1789 to 2003, there have been 79 attorneys general.

### ATTORNEYS GENERAL

Congress routinely asked the first nine attorneys general Edmund Randolph, William Bradford,

Charles Lee, Levi Lincoln, John Breckenridge, Caesar A. Rodney, William Pinkney, Richard Rush, and William Wirt to act as its counselor and render opinions of Congressional actions. But by this time, the duties of the attorney general had increased to almost unmanageable size.

The attorney general was expected to give opinions to the president, to the heads to the executive departments, and to Congress. William Wirt, the ninth attorney general, decided to remedy the situation. In 1819, Wirt wrote to President James Monroe, announcing that effective immediately, the office of the attorney general would revert to the original Judiciary Act of 1789 and render opinions only to the president and heads of the executive departments. Wirt's action did not decrease the workload of the attorneys general.

Roger B. Taney, of Dred-Scot case fame, Benjamin F. Butler and Felix Grundy served as attorneys general under Andrew Jackson and Martin Van Buren. Henry Dilworth Gilpin, the 14th attorney general from 1840–41 was born in Lancaster, England and came to the United States to earn his law degree from the University of Pennsylvania and work for Van Buren and his adopted country. John J. Crittenden served as the 15th attorney general in 1841 and the 22nd attorney general, from 1850 to 1853.

President James Buchanan appointed Edwin McMasters Stanton the 25th attorney general and he served from 1860 to 1861. In 1862, President Abraham Lincoln appointed him Secretary of War and he continued in that office until President Andrew Johnson suspended him on August 12, 1867. The Senate reinstated him on January 14, 1868, and he continued in office. President Ulysses Grant offered Stanton a justiceship on the Supreme Court, and he was confirmed on December 20, 1869, although he died before he could occupy the post.

President Abraham Lincoln appointed Edward Bates and James Speed as the 26th and 27th attorneys general. Bates, a prominent Whig anti-slavery proponent, spent one term in the House of Representatives and several terms in the Missouri state legislature. James Speed was elected to the Kentucky Legislature in 1861. Lincoln appointed him attorney general on December 2, 1864, and he remained in office until July 1866 when he resigned and resumed his practice of law.

After the Civil War, the amount of legal work involving the United States increased dramatically,



prompting the government to hire hundreds of private attorneys to help handle the workload. Eighty-one years after the 1789 Act to appoint a “meet person learned in the law” as attorney general, Congress passed the Act to Establish the Department of Justice. Grant signed the bill to establish a Department of Justice into law on June 22, 1870 and the department officially began operations on July 1, 1870. The act designated the attorney general the head of the Department of Justice and established the office of the solicitor general to assist the attorney general. The act also gave the attorney general and the department control over federal law enforcement.

President Andrew Johnson appointed Henry Stanbery attorney general in July 1866, and on March 12, 1868, Stanbery resigned to defend the president during his impeachment trial. In an ironic conclusion, when the trial ended, Johnson renominated him attorney general and also to the Supreme Court, but the Senate did not confirm him.

William Maxwell Evarts, 29th attorney general, also helped defend Johnson in his impeachment trial as principal counsel to the president. On July 15, 1868, Johnson appointed him attorney general, and he later was secretary of state under President Rutherford B. Hayes, the U.S. delegate to the International Monetary Conference at Paris, and a U.S. Senator.

Grant appointed five attorneys general: Ebenezer R. Hoar, Amos T. Akerman, George H. Williams, Edwards Pierpont and Alphonso Taft. Hoar also was a member of the Joint High Commission that framed the Treaty of Washington with Great Britain in 1873-75 and was also elected to the House of Representatives. During the Civil War, Amos T. Akerman served in the quartermaster’s department in the Confederacy and as district attorney for Georgia in 1869. Grant appointed him attorney general on June 23, 1870. As a member of the Oregon Constitutional Convention, Williams helped form the state government and completed a term as Senator from Oregon.

In 1871, he was a member of the commission to settle the Confederate ship *Alabama* claims from the Treaty of Washington. Edwards Pierpont served as attorney general from 1875 to 1876, and then became minister plenipotentiary of the United States to Great Britain. Alphonso Taft filled the cabinet post of secretary of war for Grant before he became the 34th attorney general on May 22, 1876.

After his term of office expired on March 11, 1877, he resumed practicing law, and eventually became minister to Austria and minister to Russia.

Charles Devens, attorney general for President Rutherford B. Hayes, was also Civil War hero and served as justice of the Supreme Court of Massachusetts. President James A. Garfield appointed Isaac Wayne McVeagh as attorney general and after Garfield’s assassination, McVeagh continued to serve President Chester A. Arthur until October 24, 1881, when Benjamin H. Brewster took his place.

Augustus H. Garland of Arkansas, attorney general under President Grover Cleveland, won a seat in the Confederate Provisional Congress that assembled in 1861 and was elected a member of the House of Representatives of the First Congress of the Confederate States. In 1866, Garland won a seat in the U.S. Senate, but was not allowed to take his place since Arkansas had not yet been readmitted to the Union. Later Garland served as governor of Arkansas and as Senator. Cleveland appointed him the 38th attorney general in 1885. Garland died while arguing a case before the Supreme Court. William Henry Harrison Miller, Richard Olney, Judson Harmon and Joseph McKenna, attorneys general from 1889 to 1898 rounded out the 19th century attorneys general appointed by Grover Cleveland and William McKinley.

## 20TH-CENTURY ATTORNEYS GENERAL

As the department’s workload continued to grow into the 20th century, the Justice Department expanded to include deputy attorneys general and several divisions to manage the workload. John William Griggs, McKinley’s appointee for 43rd attorney general, was also one of the first members appointed to the Permanent Court of Arbitration at The Hague, Holland. Philander Chase Knox was secretary of state under President William Howard Taft in 1909 and also served in the Senate. During his Senate career he drafted pioneering legislation that created the Department of Commerce, Department of Labor, and established the regulatory power of the Interstate Commerce Commission over railroad rates. McKinley appointed him 44th attorney general on April 5, 1901.

President Theodore Roosevelt appointed William Moody and Charles Joseph Bonaparte attorneys general. Before he became attorney general,



*The Department of Justice in Washington, D.C., uses its Antitrust Division to enforce corporate laws.*

Moody was a Congressman and secretary of the navy. He resigned the office of attorney general on December 17, 1906, to become associate justice of the Supreme Court. Charles Joseph Bonaparte spent three years as attorney general, from 1906 to 1909, after being appointed by Roosevelt. He also served as secretary of the navy, and a member of the Board of Overseers of Harvard College.

Appointed by Taft, George Woodward Wickersham served as 47th attorney general from 1909 to 1913. Two other presidents used Wickersham's talents. President Woodrow Wilson named him to serve on the War Trade Board to Cuba shortly after the United States entered World War I, and in 1929, President Herbert Hoover named him to the National Commission on Law Observance and Enforcement.

Wilson appointed three attorneys general. On March 5, 1913, Wilson chose James Clark McReynolds to be the 48th attorney general. McReynolds specialized in antitrust laws and after his tenure from 1913 to 1914, he became associate justice of the Supreme Court. Thomas Watt Gregory spent eight years as a regent of the University of Texas and worked as special assistant to the attorney general in the investigation and proceedings against the New York, New Haven and Hartford Railroad Company. He worked as attorney general from 1914 to 1919. Alexander Mitchell Palmer

served in Congress from 1909 to 1915, was a judge of the U.S. Court of Claims, and was alien property custodian under the Trading with the Enemy Act. During his tenure as 50th attorney general from 1919 to 1921, Palmer spearheaded "the Red Scare," rounding up, imprisoning, and deporting thousands of suspected communists and other "undesirables."

Harry M. Daugherty, Harlan Fiske Stone, and John G. Sargent were respectively the 51st, 52nd, and 53rd attorneys general. Daugherty served under Warren G. Harding and Calvin Coolidge from 1921 to 1924. He was acquitted of charges of defrauding the U.S. government in the Teapot Dome Scandal. Harlan Fiske Stone was dean of Columbia Law School from 1910 to 1923, and was appointed attorney general of the United States by Coolidge on April 7, 1924. Later he served as chief justice of the Supreme Court from 1941 until 1946. Coolidge appointed John Garibaldi Sargent as attorney general on March 17, 1925, and he remained in that office until March 5, 1929. Sargeant had served as chairman of the Vermont Commission on Uniform State Law, secretary for civil and military affairs of Vermont, and attorney general of Vermont.

William DeWitt Mitchell, 54th attorney general, served as an infantry officer during the Spanish American War and World War I. Hoover appointed him attorney general on March 4, 1929, and he held that office until March 4, 1933. After that he practiced law in New York City and served as chief counsel of the joint congressional committee investigating Pearl Harbor.

President Franklin D. Roosevelt appointed four attorneys general. Homer S. Cummings had been a U.S. Senator, state's attorney, and chairman of the committee on State Prison Conditions. After serving as attorney general from 1933 to 1939, he worked to improve the American prison system, and established Alcatraz Island prison in San Francisco Bay in 1934. Frank Murphy, 56th attorney general, filled a term as governor-general of the Philippine Islands in 1933, and first U.S. high commissioner to the Philippines from 1935 to 1936. He was also governor of Michigan, and an associate justice of the Supreme Court. Fifty-Seventh Attorney General Robert H. Jackson's term lasted from 1940 to 1941.

He went on to become associate justice of the Supreme Court as well, and at the end of World War II, President Harry Truman appointed him as the U.S. representative in meetings with the "Big

Three” powers (England, Russia, and France) to negotiate agreement for the international trials of German war criminals. Justice Jackson was chief counsel of those trials, the International Military Tribunal at Nuremberg, Germany.

Francis Biddle functioned as a transition attorney general between Roosevelt and Truman from 1941 to 1945. A prolific author on legal issues, one of his books was *Mr. Justice Holmes*, a memoir of his experiences as private secretary to Justice Oliver Wendell Holmes. Thomas Campbell Clark began his political career as civil district attorney for Dallas County, Texas, and moved on to the Department of Justice. Truman appointed him attorney general on July 1, 1945. After he left in 1949, Clark was appointed to the Supreme Court.

Truman also appointed James H. McGrath and James P. McGranery as 60th and 61st attorneys general. James H. McGrath was elected governor of Rhode Island in 1946, and on August 24, 1949, Truman appointed him attorney general. He resigned on April 7, 1952, and entered private law practice. James P. McGranery served in World War I as an observation pilot with the Army Air Force and was elected Congressman from Pennsylvania. In November 1943, he was appointed assistant to the attorney general and was responsible for supervising the Federal Bureau of Investigation, Immigration and Naturalization Service, Bureau of Prisons and various divisions. His term as attorney general lasted from 1952 to 1953.

President Dwight David Eisenhower selected Herbert Brownell and William Pierce Rogers as the 62nd and 63rd attorneys general. Appointed on January 21, 1953, Brownell remained in office until November 8, 1957. After that he served as the U.S. member to the Permanent Court of Arbitration at The Hague. William Pierce Rogers practiced law in New York City, served as a lieutenant commander in the U.S. Navy, and worked as chief counsel of the Senate War Investigating Committee. Eisenhower appointed him as attorney general on November 8, 1957, and he served until January 20, 1961. In 1969, President Richard M. Nixon named him secretary of state and he held that office until 1973.

## NEUTRALS AND ADVOCATES

In her study of attorneys general called *Conflicting Loyalties, Law and Politics in the Attorney General's Office, 1789–1990*, Nancy Baker argues that there

have been two kinds of attorneys general in American history: the Advocate and the Neutral. Advocates are mainly concerned with the political priorities in the administration. An advocate attorney general acts as the unofficial “president’s lawyer.” Robert F. Kennedy is probably the best example of an advocate attorney general. He spoke out passionately about the issues of poverty, discrimination, and corruption and maintained some level of involvement in political activities during his term of office.

John Mitchell, Nixon’s first attorney general, advocated for Nixon enough to become involved in the Watergate affair and spent 19 months in prison for perjury and obstruction of justice. President Ronald Reagan’s attorneys general also were involved in his administration affairs. William French Smith, Reagan’s first attorney general writes in his memoirs about the crusading spirit that he and his colleagues felt in Washington, D.C.

Reagan’s second attorney general, Edwin Meese III, sought to overturn liberal Supreme Court decisions like *Miranda* and *Roe v. Wade* by means of strong arguments before the Supreme Court and by appointing only federal judges opposing *Roe v. Wade* (the Supreme Court decision allowing legal abortion).

In her examples of Neutral attorneys general, Baker cites Edward Levi, President Gerald Ford’s attorney general. Appointed in a political atmosphere of chaos and distrust, Levi was a non-partisan academic, appointed to restore some credibility to the administration after the Watergate scandal. Griffin Bell, President Jimmy Carter’s attorney general, was appointed in the same uncertain political atmosphere as Levi. Fiercely independent, Bell reportedly clashed with Carter on several occasions for refusing to adjust his advice to the president’s views.

Baker considered President William J. Clinton’s Attorney General Janet Reno, the first female attorney general in American history, to be a Neutral as well. Both supporters and opponents of Clinton criticized her handling of the Whitewater, fund-raising, and the Monica Lewinsky scandals.

The U.S. Senate confirmed John Ashcroft’s appointment as 79th attorney general of the United States on December 22, 2000. Ashcroft pledged to renew the war on drugs, reduce gun violence and combat discrimination. He vowed to lead a professional Justice Department free from politics, and dedicated to upholding the rule of law.

## DOJ ORGANIZATION

Over the 214 years since its inception in 1789, the Department of Justice has gone through several organizations and reorganizations, dictated by presidents, precedents, and politics. At the beginning of the 21st century, the Department of Justice is divided into approximately 60 sections. Following is a summary of a few of the Justice Department divisions.

The Antitrust Division has been enforcing antitrust laws for 60 years, monitoring practices like price-fixing, conspiracies, and corporate mergers that reduce competition, and predatory acts that strengthen monopolies. Its goal is to protect economic freedom and opportunity by promoting competition in the marketplace.

The Bureau of Alcohol, Tobacco, Firearms, and Explosives dates to 1789 when the first Congress taxed imported spirits to help finance the Revolutionary War debt. The bureau has taxing powers but cannot enact or amend the law.

Established in 1957, the Bureau of Civil Rights Division is responsible for enforcing federal laws that prohibit discrimination on the basis of race, sex, handicap, religion, and national origin.

The Criminal Division of the Department of Justice under the guidance of the assistant attorney general, develops, enforces, and supervises the enforcement of all federal criminal laws except those assigned to other divisions. The Criminal Division employs 93 U.S. attorneys to oversee criminal matters under more than 900 statutes and in certain civil litigation.

The Drug Enforcement Administration's mission is to enforce the drug laws of the United States and bring lawbreakers to justice.

The Environment and Natural Resources Division enforces pollution control laws, acquires property by eminent domain for the federal government, and tries cases under wildlife protection laws. It handles Native American rights and claims.

## THE FBI AND ATF

Attorney General Charles Bonaparte created the Federal Bureau of Investigation (FBI) during the administration of Theodore Roosevelt. It began with a force of 34 agents to investigate violations of laws involving national banking, bankruptcy, naturalization, antitrusts, and land fraud. The FBI grew with

America's expanding law enforcement needs. On May 10, 1924, Attorney General Harlan Fiske Stone selected J. Edgar Hoover to head the FBI. An employee of the Department of Justice since 1917, Hoover had directed enemy alien operations during World War I and, under Attorney General A. Mitchell Palmer, had investigated suspected anarchists and communists. For the next 48 years, Hoover headed the FBI until his death on May 2, 1972. His leadership of the FBI was often controversial, but he shaped it along the Progressive lines that Roosevelt had envisioned.

In the years after Hoover, the FBI modernized and expanded its law enforcement capabilities, but not without continuing controversy. In August 1992, Deputy U.S. Marshal William Degan was killed at Ruby Ridge, Idaho, while tailing federal fugitive Randall Weaver. In the standoff, an FBI sniper killed Weaver's wife. In April 1993, at a compound in Waco, Texas, FBI agents tried to end a 51-day-standoff with a heavily armed religious sect that had killed four officers of the Bureau of Alcohol, Tobacco and Firearms (ATF). Members of the sect set the compound on fire and 80 people died. These two tragedies inspired the public and Congress to examine FBI methods and power, and the bureau has modernized and broadened itself to include more women and minorities and closer cooperation with other law enforcement agencies.

## OTHER DOJ DIVISIONS

The Federal Bureau of Prisons administers prisons and strives to make them safe, humane, and secure and to assist offenders to become future law-abiding citizens.

On March 1, 2003, the Immigration and Naturalization Service became part of the U.S. Department of Homeland Security and its functions were divided into various bureaus of that department.

Established in 1993, the National Drug Intelligence Center is part of the Justice Department and a member of the intelligence community. Its purpose is to support national policymakers and law enforcement with strategic domestic drug intelligence, support counter-drug efforts and to produce national, regional, and state drug assessments.

The Office for Domestic Preparedness was established in 1993 to assist state and local governments in acquiring sufficient equipment and training to respond to and manage terrorist inci-

dents involving weapons of mass destruction. When the Homeland Security Act of 2002 passed, the Office of Domestic Preparedness was transferred to the Department of Homeland Security from the Department of Justice's Office of Justice Programs.

Established and activated in September 2001 by Congressional directive, the Office of the Federal Detention Trustee detains federal prisoners and aliens awaiting trial or removal from the United States. The mission of the Federal Detention Trustee is to provide humane confinement of persons in federal custody awaiting trial or immigration proceedings.

The Office of Information and Privacy coordinates implementation of the Freedom of Information Act and decides all appeals pertaining to denials of access to information under the act.

The Office of the Solicitor General supervises and conducts government litigation in the Supreme Court. The United States is involved in about two-thirds of all the cases the Supreme Court decides on each year.

The Office for Victims of Crime provides small grants up to \$5,000 to grassroots community-based victim organizations and coalitions to improve outreach and services to crime victims through its Helping Outreach Programs to Expand (HOPE) initiative.

Established in 1995, the Office on Violence Against Women provides national and international leadership in addressing violence against

women. It provides grants to states and territories to train personnel, establish specialized domestic violence and sexual assault units, assist victims of violence, and hold perpetrators accountable.

The Tax Division handles or supervises civil and criminal matters that originate from the internal revenue laws. Tax Division attorneys work closely with the Internal Revenue Service and U.S. attorneys to develop tax administration policies, handle tax litigation in federal and state courts, and handle criminal prosecutions and appeals.

#### SEE ALSO

antitrust; investigation techniques; prosecution; reform and regulation; Securities and Exchange Commission; Environmental Protection Agency.

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Keating faced a series of trials in both state and federal courts. Altogether, he was convicted of 90 counts of fraud, racketeering, and conspiracy and was sentenced to 12 years in prison. Most of the charges stemmed from the sale of junk bonds that were illegally marketed to thousands of clients, many who were elderly and ill able to deal with substantial financial losses. Keating was also forced to pay \$156 million in fines, and the government auctioned off his home. While Keating was serving his sentence, a federal jury in Tucson, Arizona, awarded \$3 billion in damages against Keating and his associates for damages to the investors in the S&L swindle.

In April 1996, U.S. District Court Judge Mariana Pfaelzer set aside Keating's state convictions and ordered a new trial, deciding that the jury had been prejudiced by prior knowledge of the Keating affair, and by the behavior of Judge Lance Ito who gave the jury incorrect instructions (Ito later presided over the controversial O. J. Simpson murder trial).

In December 1996, a federal judge also threw out Keating's federal convictions, claiming that they were tainted. In a separate decision, a three-judge panel decided that the evidence used to convict Keating was far from overwhelming. Overall, Keating spent four-and-a-half years in jail and continued to publicly insist that he was innocent of all charges.

#### SEE ALSO

Keating Five; accounting fraud; savings and loan fraud; bank fraud; land flipping.

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## Keating Five

IN 1990, THE U.S. Senate Select Committee on Ethics investigated charges that Senators Alan Cranston (D-CA), Dennis DeConcini (D-AZ), John Glenn (D-OH), John McCain (R-AZ), and Donald Riegle (D-MI) had improperly interfered with government investigators on behalf of Charles Keating who had become embroiled in savings and loan (S&L) banking scandals. Contributions from Keating to the five Senators had ranged from a few thousand dollars to more than \$1 million. The five Senators strenuously objected to being lumped together and asked that each case be judged on its own merits. Nevertheless, it was almost a given that the press would view the five Senators as the "Keating Five" rather than as individuals. Objections were also made when the Senate investigating committee under the chairmanship of Republican Warren B. Rudman dealt with the five cases as a whole. In September 1989, the U.S. government brought criminal charges against Keating for fraud, racketeering and conspiracy, and the government took control of Keating's Lincoln Savings and Loan.

Much of the attention during the Senate investigation centered around two meetings that the Keating Five had with four government regulators who were investigating Keating. The investigators claimed that they were intimidated by the five senators and insisted that the purpose of the meeting was to stymie the investigation. In their view, DeConcini had been the most "hostile" of the group. Questions inevitably followed about Keating's influence on various political decisions made by the five senators, and whether the senators had intentionally interfered with the government investigation.

The American public reacted to the Senate investigation of the Keating Five with a mixture of outrage and scorn. With only one Republican among the five Senators accused of misconduct, it was a foregone conclusion that the investigation would be acrimonious and highly partisan. Rudman, chair of the Ethics Committee, claimed somewhat hopefully that the Democratic party was on the verge of collapse after losing three presidential elections and insisted that this made Democratic committee members hostile to the entire investigation. Senate rules dictated that the Ethics Committee be made up of three members of each party to avoid partisan annihilation of Senators brought be-

fore the committee. The committee had the option of either voting as bipartisans or of reporting a partisan deadlock to the Senate, which would have damaged the reputation of the entire Senate.

A number of complaints arose over leaks about the committee investigation. Democrats on the committee insisted that the leaks were coming from the Republicans. They also objected to the fact that Republicans were inclined to treat McCain and Glenn with kid gloves at the same time they were bitterly attacking Cranston, Riegle, and DeConcini.

After nine months of investigation, the committee's special counsel recommended that charges be dropped against McCain, the only Republican in the group, and Glenn who was treated with special respect as a former astronaut and a war hero. As expected, the committee split along party lines, and rejected the recommendations.

#### ALAN CRANSTON

The only one of the five senators rebuked by the Senate, Cranston had received more than \$1 million from Keating in donations to his political campaigns and to his pet political projects. The Keating Five scandal caused the 30-year career of this senator, who had spent most of his political life trying to improve the conditions for people around the world, to end on a sour note. Keating had raised \$10,000 for Cranston's unsuccessful 1984 presidential campaign and \$39,000 for his 1986 Senate reelection campaign, and also made substantial contributions to the California Democratic Party and to various Political Action Committees (PACS) with which Cranston was associated. An additional \$850,000 had been donated to three nonpartisan voter-education projects that Cranston supported.

At the time of the investigation, Cranston was suffering from prostate cancer and had decided not to run for re-election. He argued that the fact that he was leaving the Senate made him a perfect fall guy for the Ethics Committee. The Ethics Committee made a deal whereby Cranston would accept a formal Senate rebuke to avoid more serious charges. After the rebuke was announced on the floor of the Senate, Cranston apologized to his colleagues for focusing negative attention on the Senate but insisted that he had acted no differently than had most of his accusers. He may have been telling the truth because each of the 100 members

of the Senate would have been loathe to face close scrutiny of their campaign contributions.

#### DENNIS DeCONCINI

After DeConcini and Keating, a fellow Arizonian, met during the course of anti-pornography work, the two men developed a political relationship. DeConcini reportedly launched an unsuccessful attempt to convince the Ronald Reagan administration to appoint Keating as ambassador to the Bahamas. Keating raised \$33,000 and \$48,000 for DeConcini's 1982 and 1988 campaigns respectively. In March 1987, Keating allegedly asked for DeConcini's help with his banking problems, setting in place an aggressive effort on DeConcini's part to help his political contributor. However, once the government filed formal charges against Keating, DeConcini returned the \$48,000 that Keating had raised for his 1988 campaign. Republican members of the Ethics Committee believed that he should have also been rebuked by the Senate, but he was cleared of all charges.

#### JOHN GLENN

As a well-known astronaut and a fighter pilot from World War II, Glenn was an authentic American hero; and the public, the press and the Ethics Committee always viewed him as such. Keating and Glenn had been casual friends and political allies since 1970. James Grogan, who was employed by Keating as a lobbyist had once worked in Glenn's law office. In 1985, Keating donated \$200,000 to a Political Action Committee (PAC), the National Council of Public Policy, with which Glenn was closely associated, to be used for state campaigns.

Keating also contributed \$18,200 and \$24,000 to Glenn's 1984 and 1986 campaigns respectively. Glenn seemed to have an innate distrust of political contributions from Keating in the midst of the ongoing S&L investigations and turned down Grogan's offer to help raise \$100,000 for his 1984 reelection campaign. Glenn was cleared of charges.

#### JOHN MCCAIN

Like Glenn, McCain was a certified war hero. McCain had been imprisoned for over five years by the North Vietnamese during the Vietnam War. Of the five senators involved in the Keating Five scandal,

only McCain was a close personal friend of Keating. The two families had become so close that they vacationed together nine times, including a trip to Keating's vacation home in the Bahamas.

Keating had raised \$112,000 for McCain's House elections in 1982 and 1984 and for McCain's 1986 Senate campaign. The Senator insisted that he thought his wife had sent Keating a check for \$13,433 for the plane trip to the Bahamas, and he repaid Keating the \$13,433 when he was informed that Keating had claimed the amount as a tax deduction. During the investigations, McCain and Keating allegedly had a heated confrontation, and the friendship ended. McCain was cleared of all charges by the Ethics Committee.

#### DONALD RIEGLE

After beginning his political life as a Republican, Riegle had become known as a highly partisan Democrat. Riegle met Keating in 1986 at the opening of Keating's Ponchartrain Hotel. By 1987, Riegle was in line to become the chair of the Senate Banking Committee, and Keating realized that Riegle was a person worth cultivating. He offered to host a fundraiser for Riegle at the Ponchartrain and eventually raised \$78,250 for the Riegle campaign. Before that event had taken place, Riegle was allegedly asked for help in taking some of the investigative pressure off of Keating. Riegle decided not to run for re-election in 1994 even though he had been cleared of all charges.

In the wake of the Keating Five scandal, bipartisan support pushed the Ethics Reform Act of 1989 through both houses of Congress in an effort to identify what constituted ethical intervention by members of Congress in federal activities in which their constituents were involved. Congress was criticized, however, for not going far enough in specifying what constituted unethical intervention.

#### SEE ALSO

Keating, Charles; savings and loan fraud; Ethics Reform Act; corruption; ethics; prosecution.

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## Kennedy, Robert F. (1925–1968)

DURING PRESIDENT John F. Kennedy's (JFK) administration from 1961 to 1963 the fight against crime, especially organized crime and its associated white-collar crime, was waged by Attorney General Robert F. Kennedy (RFK), the president's brother. The Kennedy brothers waged a crusade against organized crime once they realized the extent of the power it wielded. The result was the Organized Crime Bill of 1962.

Although the president's father, Joseph P. Kennedy, reputedly had mob connections in his business dealings and the president shared a mistress with a well-known mobster, and enjoyed social relations with some mob-related people, RFK had long been a foe of the rampant corruption in unions, bribery of law officials, and the ever increasing hold of organized crime on the United States. He thought that crime was paralyzing the country and that government subsequently played a secondary role in the affairs on the nation.

RFK, trained as a lawyer, began his formative experiences as assistant chief counsel of the Permanent Subcommittee on Investigations headed by Joseph McCarthy. However, he eventually disagreed with the investigative methods of the committee and resigned. From 1955 to 1957, RFK served as chief counsel under Senator John McClellan's Rackets Committee and became its driving force. His tenacious and relentless pursuit of Teamster David Beck and Jimmy Hoffa earned him nationwide notice. Racketeering in the labor unions, especially the fiscal corruption of the AFL-CIO and the Teamsters was exposed.

White-collar crime, prostitution, loan sharking and gambling were rampant and dominated many aspects of U.S. society. In 1960, RFK publicized the problems of the expansive reach of organized crime in the United States with a book, *The Enemy*



*Within*. The president agreed with his decision to fight organized crime using all of the government's capabilities.

As an activist attorney general, RFK fought legislatively against the organized crime figures who had helped his brother win the election in 1960. His clandestine adventures with the Federal Bureau of Narcotics convinced him that organized crime existed despite the strong denials of Federal Bureau of Investigation (FBI) director J. Edgar Hoover. For decades, the influence of the mob intimidated or fixed juries, killed witnesses, and paid off judicial officials, including judges and police officers. Moreover, they extracted billions of dollars from the American economy without paying taxes.

RFK believed that the legal violations committed by the criminal elements would eventually disrupt the country, so he expanded the Criminal Division of the Justice Department by increasing the numbers of lawyers from 17 to 50. Grand juries meant that days in court for Justice lawyers jumped from 61 to 1,364. Secured indictments also rose, from 0 to 683 (it was 0 because the FBI had not recognized organized crime, thus no one had ever been charged). Convictions also rose from 0 to 619. This was all due to the Organized Crime Bill. To counter the anarchic crime and corruption, RFK made the unprecedented move requiring the various judicial federal government agencies to cooperate, thereby facilitating various criminal investigations. The Internal Revenue Service (IRS), for example, was brought into partnership with the FBI resulting in numerous convictions of criminals.

When JFK was assassinated, the attorney general effectively lost the power he had enjoyed as the president's brother. One effect on RFK from the assassination was to be diverted from the battle against organized crime. RFK resigned as attorney general on September 3, 1964. He ran a successful campaign as Senator from New York, and waged a liberal presidential campaign in 1968 when he was assassinated.

#### SEE ALSO

organized crime; Cuba; Racketeer Influenced Corrupt Organizations Act; Johnson, Lyndon B.

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## Kepone Scandal

WITH THE JAMES River contaminated by the toxic pesticide kepone, Virginia authorities followed a do-nothing policy dictated by lack of clean-up funds. Fines levied against Allied Chemical, the company responsible for the contamination, had first been reduced, then managed incompetently, while the commercial fishing industry urged early reopening of the river.

Kepone, a grayish white powder, was used in ant traps and to kill potato and banana plants. It was banned in the United States in 1975, the same year that the state of Virginia closed a small kepone plant near the James River, citing workers who showed signs of over-exposure to the chemical. Over-exposure first would lead to headaches, nervousness, tremors, slurred speech, muscle-twitching, poor memory, and visual disturbances, then lead to cancer, reproductive, kidney, and liver damage.

The plant, operated by Life Sciences Product Company after 1973, made kepone for Allied Chemical, had been an Allied Chemical facility from 1966 to 1973, and was owned by two former Allied employees. A state investigation discovered that the plant had illegally released kepone into the environment, first to the James River and later to the local sewage plant.

While Governor Godwin Mills immediately banned fishing on a 100-mile stretch of the James River, he also petitioned the U.S. Environmental Protection Agency (EPA) to raise the permissible level of kepone in fish, a move that would have allowed the river to be reopened. In late January 1977, U.S. District Judge Robert R. Merhige levied a record \$13.2 million fine against Allied Chemical, which pleaded no contest to 940 counts of illegal dumping.

He then agreed to reduce the fine to \$5 million if Allied Chemical created an \$8 million environmental fund for Virginia. Merhige declared that the

company's managers were "good boys in my book." That October, the *Washington Post* reported the state of Virginia levied its own \$5.25 million fine for environmental clean-up.

Only about \$5 million of the fines was earmarked for cleaning up the river and related contaminated sites. Investigations in 1985 determined that the money had been exhausted, while the James River remained choked with contaminated sediment. State officials admitted to the *Washington Post* that a natural disaster could stir up the sediment but noted that the state could afford neither the \$225,000 a year needed for monitoring nor the estimated \$2 billion required to dredge the river bottom. Available dredging methods were, by this time, as likely to do as much harm as good.

The money had been distributed among at least 50 programs, all coordinated by Roy N. Puckett, who was legendary for keeping his records in his head. After he died in 1981, the state took nine months to figure out how the money had been spent. Betty J. Diener, Virginia Secretary of Commerce and Resources, told the *Washington Post* in 1985 that the second-largest project funded from the fine had been a \$516,000 marketing campaign to help Virginia's beleaguered seafood industry. The largest project was the replacement of a sewage plant that had been damaged by kepone-laced wastes; other projects included studies of the health effects of kepone and a plan for burning kepone at sea.

The ban on fishing in the James had been partially lifted in 1980, only to be reinstated by Governor John Dalton when kepone levels in fish spiked. A circuit judge overturned that ban on the grounds that public hearings were necessary. Within hours of the judge's decision, commercial fishing fleets were working on the James, just as they had jumped the gun on the abortive January 1 lifting of the ban. When fish showed three times the permissible level of kepone, the governor invoked his emergency powers to reinstate the ban. His successor, backed by the fishing industry, petitioned the EPA to triple the permissible level of kepone in fish. EPA documents suggest that the agency had not agreed to restate permissible levels of kepone since 1977.

Although environmentalists predicted that the James River could need hundreds of years to clean itself, the Virginia Board of Health declared in 1988 that kepone levels in fish were negligible and reopened the river for commercial fishing.

#### SEE ALSO

water pollution; Environmental Protection Agency; Allied Chemical.

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## Kerr-McGee

THE GIANT OKLAHOMA-based energy company's safety record became absorbed in national questions about nuclear energy after the mysterious death of laboratory analyst Karen Silkwood. However, the Cimarron River plutonium plant where Silkwood worked was not the only Kerr-McGee property where health and safety issues have been raised.

Although Kerr-McGee began as an oil drilling operation in the Oklahoma plains, its problems centered on Kerr-McGee Nuclear, a subsidiary corporation that processed uranium and plutonium for the federal government. Plutonium, like uranium, is used in nuclear bombs and nuclear power plants. Like all of the elements used for nuclear devices, plutonium emits alpha rays: radiation that, if absorbed in sufficient quantity, can cause cells in a seemingly healthy body to reproduce in a mutated form, ultimately resulting in cancer.

The Los Alamos National Laboratories call plutonium "a very dangerous radiological hazard" due to its high emission of alpha rays. Once plutonium enters the body, it can accumulate in the

bones, lungs, and liver, where it continues to emit alpha rays long after the initial exposure.

The November 13, 1974, death of whistleblower Silkwood in a single-car accident as she drove to meet a *New York Times* reporter has spawned conspiracy theories that make it difficult to separate Kerr-McGee's actual misdeeds from plausible but unprovable notions of what might have happened. The facts that a jury accepted in 1979, awarding \$10.5 million to Silkwood's heirs, were that Kerr-McGee's negligence in its safety procedures had caused Silkwood to become contaminated with plutonium in early November 1974, putting her at serious risk for cancer later in life. At the 11-week trial, workers testified about lapses in safety, including painting over the remnants of plutonium spills, failure to disclose cancer risks to workers, advance warning of government inspections, policies of operating the plant under conditions when it should have been temporarily shut down for decontamination, and insufficient security to prevent plutonium from being removed from the plant. Radiation expert Karl Z. Morgan testified that Kerr-McGee showed a "callous, almost cruel, hardened disregard" for employee safety.

Kerr-McGee management averred that the plant was in compliance with all government regulations; however, the jury accepted the argument that, with so hazardous a substance as plutonium, compliance was not sufficient to guarantee worker safety.

The documents that Karen Silkwood had promised to the reporter—which were not found at the accident scene—were supposed to prove the existence of serious safety problems at Kerr-McGee. Silkwood's own contamination almost certainly had not occurred at work, but in the apartment she shared with fellow lab analyst Sherri Ellis. The jury rejected Kerr-McGee's defense that Silkwood had spiked her own urine samples with plutonium or had deliberately contaminated herself. Journalist Richard Rashke, in his carefully documented account of Silkwood's death and the subsequent official investigations, suggests that someone at Kerr-McGee may have contaminated Silkwood to frighten her into dropping her union activism.

The negligence suit had originally been intended as one prong of two-part assault on Kerr-McGee Nuclear. Silkwood's father and activist lawyer Dan Sheehan planned to sue the company for conspiring to violate Silkwood's civil rights by preventing

her from reporting problems. This suit was abandoned for lack of definitive evidence, even as it led into a tangle of alleged Federal Bureau of Investigation (FBI) actions against anti-nuclear activists. Government interest in protecting Kerr-McGee Nuclear would not be entirely surprising, thanks to founder Bob Kerr's long career as a powerful Oklahoma Senator.

## CHASED OFF THE ROAD

Rashke theorizes that Silkwood's fatal accident, officially attributed to sleepiness and drugs, occurred when a vehicle from Kerr-McGee or the FBI chased her off the road, presumably to prevent her from delivering proof of Kerr-McGee's negligence. He cites the report of private investigator Bill Taylor, who claims an FBI source told him of files that describe the crash. Journalist Howard Kohn argues, with less explicit evidence, that Silkwood became aware of—and may have temporarily been part of—a plutonium smuggling ring. Records cited by Rashke indicate that the plant probably was "missing" enough plutonium to make a nuclear bomb.

The \$10.5 million award was overturned on appeal. The appeals court ruled first that Silkwood's injuries had happened in the course of her work, so worker's compensation was the proper route for obtaining repayment; and second, that nuclear corporations working for the government were shielded from punitive damages by the Price-Anderson Act. Rather than pursuing a second trial, Kerr-McGee settled with the Silkwood estate for \$1.38 million in 1986. Silkwood's story was made into a successful movie, *Silkwood*, in 1983. As late as 1992, Silkwood's father was still trying to find out what really happened in the fatal car crash.

## OTHER PLANTS

The Cimarron River plant was closed in 1975. However, Rashke argues that Kerr-McGee's lack of interest in worker safety dates much further back than the Silkwood scandal and encompassed more than a single plant. There is evidence that, at Kerr-McGee's uranium mining operation on Navajo land in Arizona, Navajo workers were neither informed of the hazards of working with uranium nor provided with respirators to protect them from uranium dust, even though uranium had been implicated in miners' deaths since the 16th century.

The Atomic Energy Commission (since replaced by the Nuclear Regulatory Commission) did not express concern. There were also accidents with injuries at the Gore, Oklahoma, uranium plant in 1972 and 1986, both attributable to lack of safety precautions and inadequate worker training. Potentially radioactive liquid wastes from the Gore plant were used as fertilizer into the late 1980s.

Kerr-McGee was also casual about the fate of radioactive thorium tailings stored at a West Chicago, Illinois, plant that the company bought from American Potash in 1967 and operated until 1973. Originally owned and operated by Lindsay Light and Chemical Plant, the facility had processed thorium for decades, resulting in a 27-acre mound of tailings. With city encouragement, local homeowners turned to the four-story high pile of dirt behind the factory as a source of garden fill, not knowing that it was radioactive. After 75 nearby houses were found to have radiation levels above federal limits, Kerr-McGee officials starting negotiating clean-up arrangements. Other hot spots included a local park created from tailings fill. "No one seems to know where it all is," Larry Jensen of the regional Environmental Protection Agency (EPA) office told the *New York Times*.

#### RESIDENTIAL CLEAN UP

By fall 1998, Kerr-McGee had arranged for removal of more than 430,000 tons of contaminated soil from West Chicago. The scope of the clean up continued to expand, with negotiations starting for soil removal at an additional 600 houses and areas along Kress Creek. Contaminated soil was being shipped to a lined vault in Utah, a plan made after the community rejected Kerr-McGee's proposal to store the contaminated soil in local vaults.

By publication of its 2002 annual report, Kerr-McGee had completed clean up of the original residential areas and Reed-Keppler Park; clean up of the thorium plant was expected to finish in 2003. Two additional contaminated areas, Kress Creek and a sewage treatment plant, were still in negotiation with the EPA. Kerr-McGee was also responsible for removing contamination by toxic chemicals at a number of other closed facilities nationwide.

Kerr-McGee left the nuclear industry in 1987. As of 2003, the company's operations were in oil, gas, and titanium dioxide. Kerr-McGee's public relations notes that 11 facilities have been named Star

Worksites by the Occupational Safety and Health Administration (OSHA) in recognition of their excellent safety records. The official history on their internet site makes no mention of nuclear energy or Silkwood.

#### SEE ALSO

Silkwood, Karen; Occupational Safety and Health Act; whistleblower; employee safety.

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## kickbacks

THE TERMS *bribery* and *graft* are often used when referring to kickbacks. Kickbacks are monetary and non-monetary benefits that are paid to gain influence over and profit from an individual or firm. They are widespread and often accepted as a cost of doing business in many segments of the economy at home and abroad. Indeed, there are some segments of the economy that are more susceptible to the kickbacks, and the practice is more prevalent within some occupations. Those often cited among those most susceptible are elected officials and police officers.

James W. Coleman notes that, in cases of commercial bribery, it is often argued that the amount paid in bribes is relatively small relative to the prof-

its, and consumers bear little of the actual costs. However, the widespread practice of kickbacks gives an unfair advantage to large companies with the resources to defray the costs relative to smaller competitors. According to Coleman, companies are able to avoid the accounting problems that arise from bribes extended in the form of cash, stocks, bonds or other forms of monetary or non-monetary forms of payment by establishing dummy firms to absorb the cost. Another means of disguising kickbacks as a legitimate business expense occurs when multinational firms, unable to establish local offices, distribute payoffs through local sales agents. Firms find this an especially efficient way of conducting business because local agents are more knowledgeable about which local entities need to receive “gifts” according to cultural and structural norms. Moreover, once the sales agent is paid, multinational firms are able to plead ignorance of how money is subsequently distributed and for what purposes.

#### GOVERNMENT KICKBACKS

Bureaucratic departments and agencies are particularly susceptible to kickbacks because the government does not manufacture the products that it needs. Instead, contracts for materials and services are issued to businesses in the private sector. Officeholders are able to ensure their own financial gain through tactics such as awarding inflated contracts which then “kick back” the amount by which the contract has been inflated to the officeholders responsible for extending the contract.

Charles H. McCaghy notes another means through which kickbacks have been distributed is through donations to party campaign coffers. Contracts are extended to firms with the unspoken agreement that a voluntary campaign contribution will be forthcoming. Other times, officials might leak the amount of bids for government contracts to their preferred firms who are then able to seemingly win a contract by issuing the lowest bid.

That elected officials are particularly susceptible to the lure of kickbacks, often seeking them out, raises important questions not only about the honesty and integrity of elected officials, but also about their commitment to representing the interests of constituents. Kickbacks to politicians highlight the susceptibility of a political system to the interests of those most able to pay. Dishonesty on



*Vice-President Spiro T. Agnew resigned after pleading no contest to charges he accepted \$29,500 in kickbacks.*

the part of elected officials contributes to an atmosphere of corruption and undermines the strength of laws. What makes a kickback to public officials more insidious is the inherent difficulty in determining the extent to which individual decision-makers are swayed.

The U.S. Department of Defense has come under intense scrutiny for the kickbacks enjoyed by its employees. As detailed by Coleman, in 1982 the General Accounting Office (GAO) reported a 91 percent chance that the average military contract would feature inflated costs, and that waste attributable to graft was costing the department at least \$15 billion annually. Four years later, the U.S. attorney general for a southern California region around a high concentration of defense contractors testified that kickbacks on defense subcontracts posed a significant problem.

In 1987, coordinated efforts between the Department of Defense, the Federal Bureau of Investigation, and the Internal Revenue Service helped to hold dozens of individuals accountable for their actions. The intense scrutiny leveled at the Department of Defense uncovered egregious over-billing

evidence, such as a \$1,118.26 expense for a plastic cap for a leg of a stool, as Coleman reports.

### AUTHORITARIAN REGIMES

The impact of graft is most acutely felt and widespread in developing nations. According to international watchdog or monitoring organizations, including Transparency International which has developed its own ranking of perceived corruption in over 100 nations, kickbacks are more frequent under authoritarian regimes and newly emerging democracies. Within these contexts, kickbacks are a significant impediment to economic growth and development because a disproportionate amount of monies earmarked for new schools, hospitals, and other institutions find their way into the pockets of government officials. Graft also inhibits growth by discouraging would-be investors who frequently refer to the Transparency International index to assess the investment climate and determine risk. Due to the efforts of Transparency International, with branches in more than 60 mostly poor nations, rich countries are more aware of how their foreign aid monies are being used and have responded by suspending aid to countries where graft is most pervasive.

Governments are collaborating to decrease this practice internationally. The Organization for Economic Cooperation and Development (OECD) members agreed in 1997 to draft a treaty making it illegal for firms from member countries to bribe foreign officials. The long-term effect of such an effort is contingent upon member countries actually drafting the legislation at home, making it illegal for firms based within their countries to bribe officials elsewhere, and then to find a way to actively enforce the new laws. The United States, which already has laws in place under the 1977 Foreign Corrupt Practice Act, is urging other countries to follow suit because it stands to lose money in bids awarded to less ethical competitors abroad.

The World Bank has also joined this effort, launching surprise audits of countries to make sure loan monies are being properly applied. The bank has also blacklisted multinational firms found bribing officials abroad. Another strategy has been to illustrate the growth potential that results from serious crackdowns on corruption in developing countries. Evidence shows that nations that bring graft under control experience an overall improve-

ment in quality of life, because money that had previously lined the pockets of government officials is able to find its way into public programs.

Campaigns mounted by international organizations in their effort to discourage the practice of kickbacks frequently support measures that promote bureaucratic transparency. However, change is slow due to the fact that kickbacks have evolved into a public norm comparable to a cultural tradition. In fact, cultural differences do result in different cross-national understandings of what actually constitutes a kickback. Forging a universal definition is just one step in the right direction.

### SEE ALSO

corruption; graft; bribery; government procurement fraud; government contract fraud; Arab nations; Asia; Japan; South America; Mexico.

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## Kidder, Peabody

ONCE CONSIDERED a conservative second-tier investment firm, Kidder, Peabody survived two insider trading scandals in the 1980s before collapsing after bond trader Joseph Jett's schemes went awry. The first insider trading scandal broke in 1984, when *Wall Street Journal* columnist R. Foster Winans confessed to the Securities and Exchange Commission (SEC) that he had passed tips to broker Peter Brant. In 1985, Brant pled guilty and became the key witness against Winans, Winans' roommate David Carpenter, and Brant's long-time friend and fellow broker Kenneth Felis. All eventually served brief prison sentences.

Two years later, former Kidder, Peabody investment banker Martin Siegel, who had since moved

to rival Drexel Burnham Lambert, pled guilty to selling insider secrets to arbitrageur Ivan Boesky. Siegel's testimony implicated two bankers at Kidder, Peabody; both were arrested, but charges were later dropped. The straw that broke Kidder, Peabody's back was the \$350 million in phantom trades posted from 1992 to early 1994 by Jett, the company's Man of the Year and only African-American trader. Hired in 1991 for the company's government bond desk, Jett turned around his mediocre performance late the next year, when a glitch in newly installed software provided an opening for apparent profits.

Jett dealt in U.S. Treasury securities under the Separate Trading of Registered Interest and Principal of Securities (STRIPS) initiative. STRIPS allows traders to separate a bond into its principal and its interest, then trade the two separately. A bond would be stripped for trading, then reconstituted for its maturity date. Since bonds predictably increase in value as they near maturity, the securities market ordinarily offers low profits for low risks.

A quirk in how the software handled "forward settlements"—restitutions that were promised now but would take place in the future—allowed Jett to create large apparent profits. The system recorded a reconstitution as the purchase of a bond immediately and the sale of its related strips on the settlement date. Since the strips are inherently worth more later, this recording method created the illusion of large profits: the further away the settlement date, the larger the profit. However, when the trade was settled, the value of the bond and its strips would be nearly equal; only a small profit from recognizing undervalued strips could actually be realized. A paper profit of \$300,000 might dwindle to a real profit of \$30,000 at settlement.

By late 1993, Jett was habitually flipping strips: that is, bonds were reconstituted, then stripped again before their settlement dates, resulting in new settlement dates further in the future. The software recorded profits from each transaction, pushing his 1993 profit to over \$150 million on a trading position limited to under \$15 million. Upon firing Jett in spring 1994, Kidder, Peabody claimed he was a lone wolf who committed fraud to boost his annual performance bonuses. Jett contends he was the cat's paw in a larger scheme to hide Kidder, Peabody's financial position from parent company

General Electric (GE), which had acquired an 80 percent share in the investment house shortly before the Boesky scandal. His strips-flipping activities allowed his immediate superior, Ed Cerullo, to keep Kidder, Peabody's over-leveraged position off the books seen by GE. Jett argues that his superiors knew, approved of, even insisted on his activities. They swore to the Securities and Exchange Commission (SEC) that they never looked at his records.

The National Association of Securities Dealers (NASD) cleared Jett of fraud. A trial before an SEC administrative judge also cleared Jett of fraud but found him guilty of a books-and-records violation and ordered him to repay \$8.21 million in phantom profits. Lawyer Gary Lynch's investigation for GE absolved Kidder, Peabody executives of conspiring to commit fraud, but the *New York Times* notes that Lynch had consulting ties to Kidder, Peabody.

Late in 1994, GE liquidated Kidder, Peabody, selling most assets to rival Paine Webber, part of UBS. In 2003, Jett headed his own capital investment firm.

#### SEE ALSO

investment trust fraud; Jett, Joseph; securities fraud; National Association of Securities Dealers.

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## Knapp Commission

NEW YORK CITY'S Knapp Commission Report on Police Corruption became public in 1972, and it

comprises the most comprehensive collection of cases involving bribery of police officers. The city had experienced several previous corruption scandals prior to the Knapp Commission, including those in 1892 (quelled by Theodore Roosevelt), 1911, 1932, and 1951. The Knapp investigation was the result of information about police corruption brought to light in 1967 by former New York City detective Frank Serpico. The Knapp Commission, chaired by Whitman Knapp (who became a federal judge shortly after the commission ended), was in operation from 1967 through the end of 1972. It found pervasive corruption throughout virtually all lower ranks (through lieutenant) of the New York City Police Department, as well as among some higher officials. Not all police officers in the lower ranks were involved in blatant corruption, but most at least accepted "free" meals and services, and did not take steps to prevent what they knew or suspected as corrupt police activities.

The commission differentiated between two major forms of bribe-takers: meat eaters and grass eaters. Grass eating, the more common, refers to passively accepting bribes when appropriate situations present themselves. Meat eaters, on the other hand, are the police officers who aggressively seek out situations they can exploit for financial gain. These include gambling, drugs, and other offenses which can yield bribes totaling thousands of dollars. One highly placed police official told the commission that \$5,000 to \$50,000 payoffs to meat eaters were common; one narcotics bribe amounted to a quarter of a million dollars.

There are two types of bribes taken by the police: pads and scores. The pad refers to regularly scheduled (for example, weekly or monthly) bribes in exchange for non-enforcement of the law. Illegal gambling operations are probably the largest source of pad payments. Some detectives had collected monthly or every-other-week pads amounting to as much as \$3,500 from each gambling establishment in their jurisdiction. The monthly share (or nut) per officer ranged from \$300 or \$400 in midtown Manhattan to \$800 in the Bronx, \$1,200 in Brooklyn, and \$1,500 in Harlem. Supervisors' nuts often were a share-and-a-half. Newly assigned plainclothes officers were not given a share until after a few months in order to ascertain whether the newcomer was an informant.

A score is a one-time bribe that an officer solicits from (or is offered by) a citizen for not enforcing

the law. A police officer can score from a motorist for not writing a traffic citation or from a narcotics peddler for not making an arrest. Many officers were implicated in the solicitation of payoffs for nebulous court testimony that would result in the dropping of charges. Additionally, narcotics officers took bribes in exchange for information about an impending arrest, for the results of telephone wiretaps or other confidential police information, and for influencing the justice process for known dealers or addicts.

Gratuities, variants of the pad, refer to free meals, free goods and services, and cash tips received by officers. Gratuities were by far the most widespread form of misconduct the commission found. Several thousand free meals were consumed by the New York officers each day. The sheer numbers of gratis meals posed problems for some establishments. Tips were often given at Christmas and for the performance of normal duties.

In addition to bribery, widespread thefts by New York City police were also uncovered by the Knapp Commission. Officers admitted to taking money and house keys (for later burglaries) from corpses in their charge. They also admitted to stealing from burglary scenes. The Knapp Commission concluded that an intense sense of organizational loyalty and a disdain for outside scrutiny were the major reasons why corruption flourished. The Knapp materials clearly indicated that rationales for bribery, as well as the techniques associated with it, were learned from other officers.

Twenty years after the Knapp Commission, a new anti-corruption commission was appointed to investigate the New York City Police Department. The Mollen Commission—named for its head, Milton Mollen, a former deputy mayor and appellate judge—began its hearings in September 1993. Evidence uncovered by the Mollen Commission included many of the same things found by its predecessor—extortion, pads, and scores. Additionally, some officers were implicated as drug dealers themselves. Although the police corruption uncovered by the Mollen Commission was more isolated than that found by Knapp, organized corruption was discovered within various pockets of the city.

Taking bribes, which include anything of value (money, property, sexual or other favors), in exchange for official favors is punished under state bribery and extortion laws. Bribe-taking by federal



agents and employees (or anyone working on behalf of the United States) is punishable under 18 U.S.C. §201. Nonfederal bribe-takers acting under “color of official right” are punished under 18 U.S.C. § 1951, (Hobbs Act).

SEE ALSO

police corruption; Mollen Commission; Hobbs Act; bribery; extortion; public corruption.

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# L

## labor crimes

LABOR CRIMES are violations of laws, treaties, or international conventions (referred to hereafter simply as laws) that govern workers' rights, labor unions, collective bargaining, and other aspects of employment for specific types of workers. The concept is sometimes used more generally to cover any abusive practices related to employment. Labor crimes can be committed by employers, by labor unions, or by individual workers.

Labor laws are based on the idea that there is an inequality of bargaining power between individual workers and employers, with employers holding a stronger position than workers. As a result, wages might be "too low," while other working conditions, such as workload and working hours, might also be worse than they should be.

To remedy this inequality, labor laws define rights for workers to organize into unions and bargain collectively with employers. The theory is that by bargaining collectively, unions have a more powerful position to deal with employers than do individual workers. Because the individual worker's livelihood depends on securing employment, while a business can almost always be profitable without any individual worker, the worker is in an inherently weaker bargaining position compared with the employer's position.

However, if a business must bargain with a large number of workers organized into a union, its cost of failure to reach agreement on terms of employment rises significantly. Labor laws further "up the ante" by exposing companies to legal action—usually civil but in some cases criminal—if they violate the relevant statutes.

## LEGAL FRAMEWORK

In the United States before the 1930s, the law generally discouraged labor unions and took the side of employers. In the early 1800s, union organizing per se was sometimes seen as a crime and was prosecuted under criminal conspiracy statutes. Later courts ruled that unions could have justifiable objectives and were therefore not illegal in themselves. Subsequent cases focused on union tactics, such as pressuring non-members to support strikes.

By the 1880s, employers commonly used civil actions to thwart unions, seeking court injunctions to forbid union activities. Although the courts had recognized that unions did have legitimate objectives in advancing the interests of workers, they often ruled against union actions intended to achieve those objectives. Union activities had to be consistent with the courts' view of the "public welfare"; they could not use coercion to force workers to join unions, and could not use coercion to pre-

vent other workers (scabs) from taking jobs of workers who were out on strike. In 1890, Congress passed the Sherman Antitrust Act, aimed mainly at restricting anti-competitive activities of giant business conglomerates (trusts) such as Standard Oil. The Sherman Act outlawed “conspiracies in restraint of trade” and monopolization, though it was lax in defining what these terms meant. As a result, the law was often applied not to business trusts but to labor unions, on the theory that they were conspiracies in restraint of trade. The first major application of the Sherman Act to labor unions was in the violent Pullman railroad strike of 1893.

In response to the Pullman strike, Congress in 1898 passed the Erdman Act, which applied only to workers operating interstate trains. The law prohibited employers from firing employees, or threatening to fire them, solely because they were union members. It provided that the chairman of the U.S. Interstate Commerce Commission (a federal agency originally set up mainly to regulate railroads) could intervene to mediate labor disputes. It also encouraged arbitration as an alternative to strikes. How-

ever, employers found it easy to evade the law, often by flatly refusing to negotiate with labor unions, and the U.S. Supreme Court ultimately struck it down.

In 1914, Congress passed the Clayton Act, which favored labor unions in two ways. First, recognizing that the Sherman Act and other antitrust laws had been used for actions Congress did not intend, the Clayton Act exempted labor unions from antitrust laws. Second, it prohibited the use of federal injunctions in disputes over terms or conditions of employment. Thus, in one fell swoop, the Clayton Act removed two of the most important weapons that businesses had used to thwart the growth of labor unions.

### GROWTH OF UNIONS

In the six years following passage of the Clayton Act, U.S. labor union membership doubled, growing from 2.5 million to 5 million. In two cases from the same general time period, however, the U.S. Supreme Court considerably weakened the Clayton Act’s protections for labor unions. In addition,



*A road crew’s labor representation would work with state, municipal, or utility company management.*



*A welder’s salary and job benefits would usually be negotiated by an industrial union such as the AFL-CIO.*

businesses found new ways to fight union membership, such as “yellow dog contracts,” which the Court ruled legal in 1917. Such contracts required workers, as a condition of employment, to promise that they would not join labor unions.

In 1926, Congress passed the Railway Labor Act (RLA). Though it applied only to labor unions in the interstate railroad industry, it was amended in 1936 to include the airline industry. The RLA both legalized and formalized some aspects of collective bargaining. It set up a National Railroad Adjustment Board to arbitrate minor labor disputes and required labor and management to submit to such arbitration. It also declared that both labor and management had a duty to negotiate and to make every reasonable effort to maintain labor agreements. Finally, it set up both a mediation board and an investigative board to help push through agreements in intractable disputes. In 1930, the U.S. Supreme Court ruled that the RLA was constitutional.

During the Great Depression of 1929–41, massive unemployment led the federal government and

courts to take a more supportive view of labor laws, labor unions, and collective bargaining. In 1932, Congress passed the Norris-LaGuardia Act, which removed the power of federal courts to issue injunctions against union activities unless those activities involved fraud or violence. However, it did not require employers to negotiate with unions.

### WAGNER ACT

In 1935, the U.S. Congress passed the National Labor Relations Act, sometimes called the Wagner Act after its main legislative sponsor. The Wagner act was frankly pro-union. It affirmed rights of workers to form and join labor unions, to engage in collective bargaining with employers, and to engage in other activities related to collective bargaining. Most importantly, the Wagner Act imposed a duty on employers to negotiate with labor unions that represented their workers, and to do so “in good faith.” It set out conditions under which a particular union might be designated as the legal representative of all the workers in a particular “bargaining



*Unions gained the most membership from blue-collar workers, such as electricians and other trades.*



*A steelworker is represented by United Steelworkers of America, part of the AFL-CIO.*

unit,” ranging from an individual factory to an entire corporation. In the years following passage of the Wagner Act, U.S. union membership quintupled, growing from 3 million to 15 million.

In 1947, Congress passed the Labor-Management Relations Act, usually referred to as the Taft-Hartley Act. This law tried to rein in what its authors considered abuses by unions, such as secondary boycotts and restrictions on union membership. It established the Federal Mediation and Conciliation Service (FMCS) to help resolve disputes that could affect interstate commerce. It imposed a duty on both labor and management to inform the FMCS when they wanted changes in a collective bargaining agreement. Taft-Hartley also gave the U.S. president the power to obtain an injunction against strikes that might threaten national health and safety, postponing any strike for 80 days. Finally, the law prohibited “closed shops,” collective bargaining agreements that require the employer to hire only union members.

In 1959, Congress passed the Labor-Management Reporting and Disclosure Act, also known as the Landrum-Griffin Act. This law attempted to remedy labor union corruption and abuses that had come to light in the 1950s. The law regulated some aspects of the internal management of labor unions and stated a “bill of rights” for their members.

## NOTABLE CASES

Notable labor-crime cases would fill several volumes. A few of the most influential cases are:

*Philadelphia Cordwainer’s Case*, 1806, 3.Doc. Hist. Of Am. Ind. Soc. 59. Employees struck for higher wages. The court ruled that unions themselves were illegal criminal conspiracies, even apart from any specific activities they undertook.

*Commonwealth v. Hunt*, 45 Mass. (4 Met.) 111 (1842). A Massachusetts union sought to impose a “closed shop,” in which the employer would only hire union members. The court found that the union’s “justifiable objectives” were sufficient for its actions to be legal. The court held that for union activities to be illegal, “abuse” had to be found.

*Vegeahn v. Guntner*, 167 Mass. 92 (1896). In this case, a labor union went on strike against and picketed a furniture manufacturer. The Massachusetts Supreme Court ruled that picketing constituted intimidation and that, therefore, the manufacturer could get an injunction to prohibit picketing. Ac-

cording to one popular labor law text, “The court seemed to imply that no matter how peaceful the picketing, if it might cause discomfort to strike-breakers or customers who saw it, the picketing was unlawful.”

*United States v. Debs*, 64 F. 724 N.D. Illinois (1894); 158 U.S. 564 (1895). The first high-profile application of the Sherman Act to labor unions was in the Pullman strike of 1893. Debs was a co-founder of the American Railway Union, whose members struck against the Pullman Palace Car Company in 1893; Pullman was a manufacturer of railroad passenger cars. ARU members and others engaged in violence during the strike. The U.S. attorney general sought and received an injunction to stop the strike on the grounds that it violated the Sherman Act’s prohibition on combinations in restraint of trade. Debs and others violated the injunction and were jailed. Both the Appeals Court and the Supreme Court upheld the government’s injunction and ruled against Debs and the ARU.

*Adair v. United States*, 208 U.S. 161 (1908). Under the Erdman Act, it was illegal for railroads engaged in interstate commerce to fire workers solely because of their union membership. William Adair, an official of the Louisville and Nashville Railroad Company, violated the law when he fired a locomotive fireman for joining a union. (A train’s fireman shoveled coal into the furnace that powered the train’s engine.) The Supreme Court ruled in favor of Adair, striking down the Erdman Act as an unconstitutional interference with the freedom of contract between employers and workers.

*Duplex Printing Press v. Deering*, 254 U.S. 443 (1921) and *Bedford Cut Stone Co. v. Journeymen Stone Cutters Association of North America*, 274 U.S. 37 (1927). In both of these cases, the Supreme Court overruled the Clayton Act and allowed injunctions against union secondary boycotts of employers who refused to recognize other unions.

Though the precedent-setting labor crime cases listed above are older cases, battles are still being fought in this area. In November 2003, a settlement was reached in the case of *Ronald Walker et al v. Michael Swartz et al.*, which had been under litigation in the U.S. District Court for the Northern District of Ohio. When non-members of a union work in a bargaining unit represented by a union, they too are required to pay union dues. In this case, 223 non-union employees of Cleveland State University sued the union representing them to recover

portions of their regular dues that had been used for political activities instead of for collective bargaining.

#### SEE ALSO

wage crimes; unions; boycotts; employee safety; Sherman Antitrust Act; Clayton Antitrust Act.

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## Leeson, Nick (1967–)

NICK LEESON, the financial trader whose trading losses led to the collapse of Barings Bank, was born in Watford, Essex, England, the son of a plasterer. After leaving Parmiter's School, aged 18 in 1985, Leeson got a job working as an accounts clerk for the bank Coutts & Company settling checks. In June 1987, Leeson moved to the London branch of the American investment bank Morgan Stanley where he worked in the Settlements Division for Futures and Options. In June 1989, Leeson left Morgan Stanley, taking a job in the Settlements Division for Futures and Options of Barings Securities, the trading arm of Barings Bank, Great Britain's oldest merchant bank, founded more than 240 years ago in 1762.

Leeson created a reputation as a settlements expert after clearing a £100 million backlog of share certificates at the bank's Jakarta, Indonesia, office during 1990 and 1991. In the spring of 1992, Barings sent Leeson to work at the Singapore International Monetary Exchange (SIMEX). A year after arriving in Singapore, Leeson had made more than £10 million, approximately 10 percent of Baring's total profit for 1993, and earned a bonus of £130,000 in addition to his salary of £50,000. In

reality, Leeson had taken huge losses, which he hid in a dormant error account. Leeson attempted to trade his way out of the situation.

However, his gamble failed spectacularly due to a downturn in the Asian financial markets that was exacerbated by the Kobe, Japan, earthquake; Leeson was left with losses of £208 million. He went on the run, fleeing to Malaysia and Borneo before attempting to return to the United Kingdom. On March 2, 1995, German police arrested Leeson at Frankfurt airport; he spent the next nine months in a Frankfurt jail resisting extradition to Singapore. An audit of Barings Singaporean operations revealed that Leeson had run up losses of £827 million, a sum nearly equal to the value of Baring's entire assets. Barings Bank collapsed on February 26, 1995, and was bought for £1 by the Dutch banking and insurance group ING.

A Bank of England investigation of the Barings collapse attributed the debacle to a failure of control. The report implicated numerous bank executives who chose to resign or were fired. On December 1, 1995, Leeson pleaded guilty to fraud and was sentenced to six-and-a-half years in Torah Merah prison, Changi, Singapore. While serving his prison sentence, Leeson published his autobiography, *Rogue Trader*, in which he condemned Barings for its failure to supervise his illicit trading activities.

In 1999, Leeson was diagnosed with cancer of the colon and released from prison on July 3 having served three-and-a-half years of his sentence. On his arrival at London's Heathrow airport, the liquidators of Barings Bank served Leeson with an injunction for £100 million. In 2004, Leeson was making a living as an after-dinner speaker after completing an undergraduate degree in psychology at Middlesex University.

#### SEE ALSO

bank fraud; securities fraud; Barings Bank: Asia; investment trust fraud; accounting fraud.

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## legal malpractice

LEGAL malpractice, sometimes also known as lawyers' professional liability, refers to wrongdoings by attorneys in the course of performing legal services which result in civil liability. There are three major areas in which legal malpractice may occur: 1) negligent actions; 2) breach of contract between lawyer and client; and 3) breaches of fiduciary duty (negligent financial practices in handling clients' money). Specific types of legal malpractice include tampering with or concealing evidence, negligent advice to clients, giving legal opinions to third parties, assisting others in committing crimes, misrepresentations of professional credentials, accepting illegal money and plagiarism of legal documents.

### MALPRACTICE HISTORY

While legal malpractice was the subject of cases as far back as the 18th century in the United States, it has only been since the 1960s that lawyers' professional liability has been significantly expanded. Unlike most other professions, lawyers pervade most aspects of economics, society, and politics, and their actions affect others in very concrete ways.

Indeed, the fact that they are necessary for the conduct of such a wide range of personal, economic, and political practices has made attorneys particularly vulnerable to public and legislative censure. As in other areas of civil law, changing social, economic, and political attitudes by legislators, judges, and the general population have shaped the extent of liability for those practicing the legal profession.

The English common law of negligence was actually first applied in the 18th century to professionals such as lawyers who professed competency in a specialized field. In *Russell v. Palmer* (1767) and *Pitt v. Yalden* (1787), the courts held lawyers liable for negligent practices in relation to their clients. In reaction to such cases, judges attempted to protect their lawyer colleagues by holding that only certain types of lawyers were liable for negligence. Nonetheless, it soon became common to hold lawyers to "an ordinary degree of skill and care" in performing their services.

The 1776 case *Stevens v. White* was the first case in the United States involving lawyers' liability. The defendant lawyer claimed that his client, who had suffered damages due to the lawyers' actions, had

not paid for his services so that he had no duty to properly represent his client. Yet, the court found that since the attorney had originally agreed to provide services to his client, he was judged liable for negligence. In the 1880s, the landmark U.S. Supreme Court case of *National Savings Bank v. Ward* further clarified the laws governing legal work. The lawyer in this case was employed by a bank to investigate if the land put up as collateral by a prospective borrower was sufficient to cover the loan. The bank loaned \$3,500 to the client and then accepted the property as security for the loan. However, it turned out the borrower did not actually own the land and was bankrupt. The attorney was found liable for negligence.

In defending the decision, Justice Nathan Clifford offered a definition of negligent actions by lawyers which would prevail for the next century, "When a person adopts the legal profession... he must be understood as promising to employ a reasonable degree of care and skill in the performance of such duties, and if injury results to the client from the want of such a degree of reasonable care and skill, the attorney may be held to respond to damages to the extent of the injury sustained." He went on to say that proof of the employment relationship and a failure to perform duty in a reasonable manner were the only two prerequisites to winning a suit for negligence against a lawyer. This case thus established two precedents which would hold until the 1960s. To prove negligence, there had to be: 1) a contractual relationship between lawyer and client and; 2) a breach of duty.

In the century following this decision, judges and juries also debated the question of whether lawyers' liability should be tried within actions arising from breach of contract (contract law) or through breach of the standard of care (negligence under tort law.) If the case brought against a lawyer was argued as negligence, the court was responsible for deciding if negligence occurred. Yet cases brought against attorneys on the basis of breach of contract were also decided on the basis of duty in performing legal duties. The differences between the two approaches revolved around the extent of damages and the Statute of Limitations (limitations on the duration of time in which a client may legally sue for damages.)

Damages awarded to plaintiffs in breach of contract cases have generally been much more limited than in cases brought on the basis of negligence.

Furthermore, punitive damages were generally disallowed in such cases. The Statute of Limitations, however, is considerably longer in contract law than in tort law.

Often the most crucial points in legal malpractice cases was the question of privity, that is, the relationship between the lawyer and the plaintiff suing for damages. In this area, lawyers enjoyed considerable limitations on liability. Lawyers were only responsible to clients with whom they had a contractual relationship. Third-party claimants who suffered damages were generally ineligible to sue a lawyer for malpractice if they were not in privity. Another benefit granted to lawyers under this regime was the ambiguous nature of the concept of duty and reasonable care and the leeway that the Statute of Limitations offered to lawyers. Even though legal services gradually became more specialized over the course of the 20th century, lawyers were only held to an "ordinary" standard of care. As Mark Robert Fried concisely states, "A lawyer was held to the standard of care of a general practitioner even though he had represented himself as specially qualified in a particular area of law." Lawyers also enjoyed the protection of the Statute of Limitations since realistically clients were frequently unable to discover negligent actions within the time frame allowed.

## THE LEGAL PROFESSION

It is also important to trace developments in the legal profession itself to understand professional liability for legal professionals. Only in the late 19th and early 20th century were professional standards and ethics gradually developed among lawyers. Well into the 20th century, states required varying levels of professional education and training among lawyers, and licensing regimes varied considerably by jurisdiction. Until the second half of the 20th century, many lawyers, for instance, did not belong to professional associations such as the American Bar Association which first passed a code of ethics in 1908. The legal profession preferred to govern itself and thus laid itself open to abuses by members of the profession, although by the post-war period, there were a plethora of codes of ethics and statements of professional conduct established by state and federal professional associations.

By the mid- to late-20th century, the legal profession found itself facing increasingly higher risks

of malpractice suits. The reasons for this vary. For one, the public itself had changed. Clients became increasingly educated and were not so ignorant of legal processes and their rights. As Dennis Gillen suggests, "The public [had] also become more resentful toward individuals who attempt to claim immunity by virtue of their profession." The development of malpractice insurance, moreover, fostered a willingness on the part of clients to rigorously pursue suits against what they perceived as negligent actions by their legal counsel. These developments corresponded to similar expansions of liability for corporate entities within tort law.

In the 1958 California Supreme Court case, *Bikanya v. Irving*, the judges held that lack of privity no longer prohibited actions for negligence against lawyers. From this decision onward, courts in many states have therefore found lawyers liable for damages incurred by certain third-parties. Cases since the 1960s have also found that legal malpractice constitutes both a tort and a breach of contract allowing plaintiffs to sue on a wider basis. Laws governing the Statute of Limitations have also been relaxed in favor of clients suing their lawyers. A simpler definition of negligence has been adopted in many jurisdictions making it easier to prove malpractice. Some states have abolished "good faith" defenses which were used in cases where lawyers erred, but acted in good faith. Lawyers have recently had to face courts which have defined "duty" and standard of care in a much more objective and stricter manner than lawyers faced in the past.

Cases of legal malpractice have usually arisen in civil law. It is worth mentioning, however, that state-appointed attorneys have also been found negligent in handling criminal cases. Several high-profile cases have surfaced in recent years focusing on the alleged malpractice of state-appointed lawyers in death-penalty cases. It was found that clients in these cases, often poor African-Americans and Hispanics unable to afford legal representation, suffered extensively from negligent practices by poorly trained lawyers.

The last two decades have seen dramatic increases in legal malpractice suits. Lawyers have finally been subjected to the same standards of accountability as doctors, accountants, surveyors, and inspectors. One reflection of this is that there has been a trend toward law firms shifting from partnerships to professional corporations, limited liability companies, or limited liability partnerships



to lower the risk of financial penalties in the event of malpractice.

If current trends continue, the following decades will likely see an increasingly uniform use of objective standards of care and other broader notions of professional liability, bringing legal professionals in line with their peers in other professions.

#### SEE ALSO

fiduciary fraud; negligence; United States; United Kingdom.

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## Levi, Michael (1948–)

IN 2004, MICHAEL LEVI was a professor of criminology at Cardiff University in Wales, England. Levi has addressed the problem of financial havens and bank secrecy in his work, as well as the process and rewards of becoming a white-collar criminal. Levi earned a M.A. degree from the University of Oxford, a Diploma in Criminology from the Institute of Criminology at the University of Cambridge, and finally a Ph.D. from the University of Southampton.

Most of Levi's research and writings have been about the prevention and criminal processing of white-collar and organized crime, including money laundering and asset confiscation. In 1997, he was

chosen by the Strasbourg (France)-based Council of Europe to serve as its scientific expert on a new major initiative on organized crime. The council, Europe's oldest union of nations, is dedicated to promoting human rights and democracy, both of which are threatened by organized crime. Levi has also acted as a consultant to the United Nations and to the United Kingdom's Home Office Police Research Group.

Levi insists that it is inaccurate to think of the typical white-collar criminal as a person who just happened to take advantage of a criminal opportunity. Some white-collar criminals, like other types of entrepreneurs, may be people of vision who can detect possibilities of exploitation in their environment that remain invisible to others. People also become fraudsters via the transmission of information from people in the underworld who have carried out long-term frauds themselves, or who have learned the techniques from someone else.

The poor prosecution of white-collar crime has allowed many criminals to keep the profits. Levi discovered that British confiscation orders constitute a very small percentage of the estimated proceeds of drug trafficking. The orders are essentially civil in nature, making them out of place in the criminal justice system and making enforcement erratic. There is no organizational incentive for anyone to deal vigorously with confiscation matters in part because no percentage of assets confiscated is turned over to agencies for further use in combating drug trafficking.

Money laundering has emerged as one of the major types of white-collar crime. In a 1998 report prepared for the United Nations' Global Program Against Money Laundering, Levi acknowledged that criminal organizations have taken increasing advantage of financial havens and off-shore banking centers to launder money. These havens enforce strict financial secrecy, which serves to shield the criminal from regulatory authorities. Levi argues that all citizens must be legally accountable for government to work and that bank secrecy laws protect against legal accountability instead of privacy violations. Levi has called for an international convention on the privacy issues surrounding the electronic exchange of information and banks.

#### SEE ALSO

United Kingdom; money laundering; drug trafficking; organized crime; corruption; offshore entities.

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## Levine, Dennis (1952–)

INVESTMENT BANKER Dennis Levine's rise from working-class Queens (New York City) boy to multimillionaire seemed to justify the 1980s ethos of greed—until he was arrested for insider trading. On May 12, 1986, Levine fled Department of Justice (DOJ) officials who were waiting outside his office at Drexel Burnham Lambert.

In his autobiography, Levine remembers himself as an innocent young banker tempted into insider trading by colleague Robert Wilkis in his first job at Citibank. Investigative reporter Douglas Frantz argues that it was Levine who introduced Wilkis to insider trading after Levine had moved to Smith Barney and Wilkis to Lazard Frères. Levine envisioned creating a ring of sources at major investment houses, all pooling confidential information to make profitable trades ahead of the market. Meanwhile, his first secret overseas trading account was prospering.

Late in 1984, Drexel Burnham Lambert, home of junk bond manipulator Michael Milken, hired Levine as a managing director, intending to make him a mergers-and-acquisitions star. Invited in his first week to participate in Coastal Corporation's \$2 billion acquisition of American Natural Resources (ANR), Levine turned his inside information into a \$1.4 million personal profit. Levine blamed arbitrageurs such as Ivan Boesky for the heavy trading in ANR stock that forced Coastal to pay more for ANR. It was Levine who fed Boesky the inside information about ANR. Soon the two had a formal arrangement in which Boesky paid Levine for tips.

When an anonymous letter from Venezuela told brokerage Merrill Lynch that two of its people in Caracas were trading on insider information, the trail led first to Lynch broker Brian Campbell, then

to Levine's \$10 million secret trading account at Bank Leu in the Bahamas. After Levine surrendered to the DOJ, he turned in Boesky and the remainder of his insider trading ring, starting a long-running insider trading scandal. At his February 1987 sentencing for perjury, securities fraud, and tax evasion, the judge lauded Levine's "extraordinary" cooperation in leading investigators to "a nest of vipers." Levine was sentenced to two years in prison and a \$362,000 fine.

Levine emerged briefly from prison in June 1987 to testify before a closed Congressional hearing on insider trading. Commented Representative Gerry Sikorski (D-MN): "It was not a story that engendered compassion. It was more akin to the curiosity one feels when one turns over a rock in a brook and looks to see what's underneath." In December 1988, Drexel settled with the DOJ for six felony counts and \$650 million in fines, all related to employees implicated in Levine's ring. (Unrelated charges against Milken were not included.) Drexel went bankrupt and closed. After his release from prison, Levine became president of ADASAR Group, a financial consulting firm.

### SEE ALSO

insider trading; Drexel Burnham Lambert; offshore entities; Justice, Department of; tax evasion.

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## Lloyd's of London

FOR MORE THAN three centuries, Lloyd's of London evoked sterling images of respectability, dependability, and exclusivity. As an insurer, over the years, Lloyd's developed a reputation for promptly

paying all legitimate claims. While Lloyd's had been involved in minor scandals in the past, in the late 1980s, Lloyd's became involved in the worst scandal of its illustrious career. The scandal resulted in hundreds of lost fortunes, totaling approximately \$13 billion (£8 billion) and involving almost 2,000 of Lloyd's 34,000 "Names" (what Lloyd's calls its individual investors). The scandal also changed Lloyd's focus from investment by Names to corporate investors, particularly insurance companies from all over the world. By 1996, it was evident that Lloyd's would survive, but some of the Names were not so fortunate. Some of them had committed suicide during the crisis.

### NAMES AND MORE NAMES

In 1950, Lloyd's of London limited its exclusive list of Names to 2,743 investors, most of whom were located in England. Over the next five years, the number of Names increased to 3,917. The next two decades saw steady increases in the number of Names as the list grew from 5,828 in 1965 to 7,660 in 1975. The most astonishing rise in Names began in 1975 and continued until the late 1980s as Lloyd's struggled to recoup substantial losses from a number of claims filed in the wake of disasters, both natural and human-made.

By 1985, Lloyd's boasted over 26,000 Names, and the number of investors continued to rise, with approximately 15 percent of the total being American and Canadian Names. Many of the North American Names were recruited by "members' agents" who received hefty commissions on the number of Names they recruited. It was later claimed that the North American Names, as well as those from other countries outside England, had been specifically recruited to bear the brunt of Lloyd's losses.

Most of Lloyd's North American Names were upper middle-class professionals and business people and their spouses. The Names were attracted to Lloyd's because of its stability and the guarantee of a quick return on what seemed to be a no-risk investment. On the surface, the method of investing in Lloyd's seemed simple: Individual names placed at least \$150,000 in stocks and bonds in a Lloyd's account and pledged at least \$400,000 in additional assets and credit. Technically, the funds were available to Lloyd's to pay out claims. However, Lloyd's rarely needed to tap the accounts for large sums, so

the funds steadily grew as premium payments were paid into trusts that each syndicate opened for its Names.

These approximately 400 syndicates made up what was essentially a lot of small companies under the Lloyd's of London umbrella. The amount received from premium payments varied according to the amount deposited in each Name's Lloyd's account. Likewise, when Lloyd's needed to withdraw funds to cover its losses, the amounts taken from each client were based on each Name's share of the total premiums issued by the syndicate. Each Name retained ownership of his/her Lloyd's deposit and earned profits according to the amount of pledged assets. It was common practice among English families who had inherited family property without sufficient funds to keep up their estates to become Names by pledging their lands as assets, allowing them to maintain their property with profits from Lloyd's accounts.

The practice of getting something for nothing from Lloyd's accounts ended in 1987 when a series of disasters placed an enormous drain on the financial assets of Names in certain syndicates. While it would seem that most of these claims were irrelevant to Lloyd's, the company was drawn in because of the practice of underwriting and reinsuring other insurance companies around the world. Lloyd's was well known for underwriting high-risk insurance policies. A large number of American claims were asbestos-related as scores of former asbestos workers became ill after being exposed to asbestos on their jobs decades before. Since their claims were made against valid policies, Lloyd's was required to honor them. Lloyd's also paid on American claims related to exposure to toxic wastes that had also occurred years before.

On October 15, 1987, Great Britain experienced its first hurricane in 200 years, resulting in losses to property amounting to some \$3 billion; claims poured in to Lloyd's. The following year, a large number of disaster-related claims were filed with the company arising from the Piper Alpha oil rig explosion in the North Sea on July 7, 1988, in which 167 lives were lost. The crash of Pam Am flight 103 over Lockerbie, Scotland, on December 22, 1988, which claimed an additional 270 lives, further drained Lloyd's resources.

Additional claims were made after Hurricane Hugo touched down in the U.S. Carolinas on September 21, 1989, leaving behind over \$7 million in

damages. The following month, San Francisco, California was hit by a major earthquake. Both disasters generated numerous claims on Lloyd's resources. By that point, Lloyd's needed over \$4 billion to meet incoming claims. When Lloyd's demanded that Names in some syndicates deliver their assets to meet Lloyd's shortfall, whole fortunes were wiped out. Thirty percent (about 7,000) Names were asked to bear the greatest share of the burden. American Names responded by filing numerous lawsuits, claiming that Lloyd's should have been forced to seek approval from the Securities and Exchange Commission (SEC) before doing business with Americans, and charging that agents had recruited Americans in order to bear the burden of Lloyd's losses.

In response to the serious economic crises it had caused for the Names, Lloyd's established a Hardship Committee to help investors locate necessary funds without wiping out all assets. Over 300 people applied for help, but Lloyd's never backed down from its demands. By 1991, close to 4,000 Names had resigned from membership in Lloyd's of London, while others scaled down their investments. Lloyd's also found itself in trouble with Inland Revenue, Britain's tax service, for depositing large sums of Names' investment money in offshore banks without their knowledge. Lloyd's was forced to pay the British government the money it has lost through the tax evasion scheme.

In the spring of 1995, Lloyd's announced a \$3.8 billion settlement to be distributed among the Names that had been faced with financial ruin during Lloyd's crisis. Continuing its policy of using the private fortunes of its investors to mitigate its losses, Lloyd's asked Names who had not suffered losses to put up approximately \$30 million of the settlement funds. Additional funds were solicited from insurance company investors.

#### SEE ALSO

securities fraud; insurance fraud; investment trust scandals; offshore entities; tax evasion.

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INDEPENDENT SCHOLAR

## Lockheed

IN 1909, AVIATOR Glenn L. Martin expanded his small aircraft construction business into Lockheed Martin Corporation, which became one of the most prominent aircraft suppliers in the world. In the years immediately after World War II, Europe was rebuilding its economy, and American businesses traded with former enemies as well as with former allies. International trade with developing countries was also on the rise. Expanded world markets offered enormous profits, and Lockheed was eager to make the most of its opportunities.

Money poured in from Lockheed sales to Japan, Germany, Italy, the Netherlands, West Germany, Indonesia, Turkey, Brazil, the Philippines, Saudi Arabia, and a number of other countries. Lockheed's problems started when William Findley, an independent auditor simply doing his job, discovered Lockheed's "unusual" accounting practices and began to wonder why Lockheed was making such huge contributions to a fund for widows and orphans in Djakarta, Indonesia, and to the Indonesian Air Force. Findley was most surprised by a Lockheed receipt that read: "I received One Hundred Peanuts." He was even more astonished when he learned that "One Hundred Peanuts" literally meant the receipt was for one million Japanese yen.

In June 1973, the head of Northrop Corporation, a Lockheed rival, admitted to a subcommittee of the U.S. Senate that his company had also paid "consultants" to facilitate business deals with foreign governments, adding that Northrop's secret agreements were patterned after those used by Lockheed. The resulting scandal led Senator Frank Church, chair of the Church Committee that investigated the Lockheed scandal, to remark that Lockheed's activities encompassed "a sordid tale of bribery, and of shadowy figures operating behind the scenes with a cast of characters [straight] out of a novel of international intrigue." Investigators discovered that between 1972 and 1974, the president

of Lockheed, A. Carl Kotchian, had paid millions of dollars to Japanese sales consultants, secret agents, businessmen, and the Japanese government to facilitate the sale of Lockheed planes to All Nippon Airlines. Upon learning of the Lockheed scandal, Japanese merchants seized on the wording of the receipt that auditor Findley had discovered. Souvenir handkerchiefs were sold, which read: "I received One Hundred Peanuts." Foreign governments did not treat the scandals so lightly. Many of Lockheed's cohorts stood trial and received various punishments.

### INTERNATIONAL BRIBERY

The Senate learned that money had been paid into Swiss bank accounts, dummy corporations, and "charities." Most Americans were horrified to learn that a share of the Japanese payments had been given to General Minoru Genda, the architect of the attack on Pearl Harbor on December 7, 1941, which had propelled the United States into World War II. Further investigation revealed that, in 1959, Genda visited Lockheed's Burbank, California, headquarters to test Lockheed's Starfighter. Japan had subsequently purchased 230 Starfighters. Yoshio Kadama, a Japanese agent who was considered one of the most powerful men in Japan and who was secretly on Lockheed's payroll, received \$1.7 million for his services on the Starfighter deal. Overall, Lockheed paid over \$12 million to various individuals in Japan through Kadama.

Lockheed had also sought to influence purchasing decisions in a number of other countries. In West Germany, for example, Lockheed worked with Franz Joseph Strauss, the Minister of Defense, who purchased 96 Lockheed planes in 1959. In return, Lockheed paid a percentage of the sales on all Lockheed planes sold to the West German government to the West German Air Force, Strauss's Christian Socialist Union political party, and various other West German political and military officials.

In the Netherlands, Lockheed paid Prince Bernhard, the husband of Queen Julianna, \$1 million, depositing the money into a Swiss bank account. The prince later resigned in disgrace from all public offices, and the Dutch government purchased planes from the French. From 1969 to 1971, Lockheed paid Italian government agents over \$2 million to facilitate the sale of Lockheed planes. The indi-

viduals who received payments from Lockheed were later brought to trial in the Italian courts.

Lockheed's relations with the Indonesian government went back as far as the mid-1950s. In 1966, the newly elected Indonesian president specified that no payments could be remitted to individuals but should instead be made to government-sponsored agencies. Initially, the Widows and Orphans fund in Djakarta, Indonesia, received 5 percent on all Lockheed sales to the Indonesian government but the payment was later raised to 10 percent. Few people believed that the Lockheed payments had actually supported widows and orphans.

Ironically, Lockheed's payments to foreign agents were not a violation of American law, and the practice of paying consultants and foreign governments was not uncommon. Nonetheless, Kotchian later acknowledged that he did not act ethically in the matter. He also admitted that Lockheed's profits would have suffered if he had not cooperated with foreign governments. The money realized on such sales had helped Lockheed to recover from a billion-dollar cost overrun that resulted from the production of Lockheed's first jumbo jet. It also saved thousands of jobs for employees of this company that was known for its frequent layoffs.

The Congressional investigation into Lockheed's activities motivated Congress to pass the Foreign Corrupt Practices, which President Jimmy Carter signed into law in 1977. The act made it a criminal offense to offer or pay money to government officials of foreign countries or to any individuals who intended to pass on such payments to foreign government officials for the purposes of obtaining or retaining business in those countries. Exceptions were made for payments to officials whose duties were chiefly ministerial or clerical. While the law established limits on the actions of American businesses doing business in foreign countries, its failure to distinguish between bribery and extortion was considered a major weakness.

### SEE ALSO

bribery; extortion; Foreign Corrupt Practices Act; Northrop Grumman; corruption.

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## Love Canal

WHEN MOST PEOPLE think of Niagara Falls, New York, they picture the beautiful spectacle and one of the world's wonders, that of Niagara Falls. However, many may not think of this awesome sight but instead images of toxic waste and houses that were rumored to glow. Just east of the Falls is the site of the Love Canal and the tragedy that fell on a small community.

In the 1890s, a man named William T. Love bought a small tract of land and dug a short canal between the upper and lower Niagara Rivers. He felt that power could be generated cheaply to fuel the industry and homes that would be developed. Unfortunately, Love's project was never finished and the canal that was supposed to be used as a way for a town to prosper was instead used as a dumping ground for a variety of municipal and industrial wastes.

The City of Niagara Falls started the dumping. In 1920, the canal was sold in a public auction to the municipality for use as a landfill. The U.S. Army was also responsible for dumping chemical warfare material. Hooker Chemical Company started to use the canal for a chemical dump site in 1942 when they negotiated with the city of Niagara Falls to buy the property. During the period 1942-53, Hooker owned the land and was the primary company disposing of its wastes into the canal. At this time, there were no regulations or laws prohibiting such activity. Hooker dumped over 21,800 tons of toxic chemical wastes on the site. Included in these chemicals were benzene hexachloride, chlorobenzenes, and 400,000 pounds of dioxin-contaminated trichlorophenol. All of these chemicals are highly carcinogenic (cancer-causing).

In 1952, the Niagara Falls School Board wanted to buy a part of the Love Canal property in order to build a new grade school so they approached Hooker. The population in Niagara Falls was grow-

ing and the local school board was pressuring Hooker to sell the undeveloped land. Hooker felt that it was not wise to build on the land since it was used as a dump site for over 10 years. The school board threatened the use of eminent domain and continued to pressure Hooker to give up the land. Hooker was still against the use of the land and tried to convince the school board that they should avoid building underground facilities of any kind, given the type and amount of chemicals that were disposed of on the property.

After much pressure, Hooker was willing to donate the property for \$1, only if several conditions were guaranteed. Hooker wanted the school board to take the entire property and indemnify Hooker from any future claims. The school board refused and Hooker relinquished ownership when there was no other choice, and before the school board invoked eminent domain. Hooker covered the wastes with a protective clay cap and sold the 16-acre parcel for \$1. Hooker tried to advise all of the parties involved about the chemicals that were buried on the site and that any building that was to be done should be done without disturbing the site. Parking lots and other above ground facilities would be appropriate, but building a school and houses would not be. In spite of these warnings, the city of Niagara Falls developed the land.

From 1954 through the mid-1970s, there were a series of incidents which showed the danger of breaking the ground around the canal. The ground subsided and old drums of toxic wastes rose to the surface. Complaints of foul odors and chemical residues, first reported in the 1960s, increased during the 1970s, as heavy rainfall caused the groundwater to rise, flooding area basements. Hooker was called to the site various times, but the company tried to explain to the city that they were no longer responsible for the site, the school board was since the site was transferred to them. However, the school board was protected by sovereign immunity (government officials cannot be held responsible for mistakes otherwise they would avoid making them, making it impossible to do their job). Therefore, the responsibility fell back on the Hooker Chemical Company.

During the summer of 1978, Love Canal first came to international attention. Through the courageous battle fought by Lois Gibbs, a local resident, and others in the area, the Love Canal area was declared a national emergency. In 1978, 239 families

were evacuated and relocated by the U.S. government, and their homes destroyed. More families were relocated at a later date. There were 564 homes that were designated in the Emergency Declaration area. Residents of all but 72 of the 564 homes chose to move. More than 900 families were forced to leave their homes so the site could be cleaned.

### CREATION OF THE EPA

It was not until the 1970s that the Environmental Protection Agency (EPA) was created to study the effects and regulate the thousands of chemicals used in the United States. President Richard M. Nixon declared his intention to establish the Environmental Protection Agency with Reorganization Plan Number 3, dated July 9, 1970. The EPA's mission would include: "The establishment and enforcement of environmental protection standards consistent with national environmental goals. The conduct of research on the adverse effects of pollution and on methods and equipment for controlling it; the gathering of information on pollution; and the use of this information in strengthening environmental protection programs and recommending policy changes ... assisting others, through grants, technical assistance and other means, in arresting pollution of the environment... assisting the Council on Environmental Quality in developing and recommending to the president new policies for the protection of the environment." After being cleared through hearings in the Senate and House of Representatives, the EPA was inaugurated on December 2, 1970.

Love Canal was the first hazardous waste disposal case to draw national attention, and it remains to this day a landmark case. The disaster at Love Canal led to the creation of the EPA's Superfund law in 1980. Superfund makes responsible parties liable for the cleanup costs of such environmental disasters. The Love Canal court battle provided one of the first tests of the Comprehensive Emergency Response, Compensation and Liability Act (CERCLA, also known as Superfund). The site was officially placed on EPA's list of hazardous waste sites needing cleanup in 1983. EPA worked with the state to cap the land to prevent rainwater from reaching the waste, built a system to clean water draining from the site, cleaned out debris from the sewers and surrounding creeks, and removed polluted soil from nearby schools and residential properties.

Even though Hooker tried to claim that they were not responsible for the disaster; they did settle and ended up paying over \$227 million for the clean up. Since the dumping occurred before the EPA was created, no punitive damages were warranted because the actions of Hooker were not illegal at the time of the actual dumping. Even though Hooker settled and paid much of the cost of cleanup, the largest price paid for the cleanup came from the taxpayers. It cost over \$30 million to evacuate the area and \$250 million to clean up the site. If the Hooker Chemical Company had refused to sell to the city of Niagara Falls or cleaned up the site before the sale, or if the city of Niagara Falls had heeded Hooker's warnings, this disaster could have been avoided.

Early investigations of the Love Canal area confirmed the existence of toxins in the soil and determined that they were responsible for the area's unusually high rates of cancer, miscarriages, and birth defects. But, these results have been highly criticized. There have been no conclusive studies done of Love Canal's actual effects on its residents' health. This is mainly due to the lack of tracking of the families that had relocated. Residents of the area have complained of health problems, but whether or not Love Canal is to blame has not been conclusively determined.

Today, the waterway that gave the neighborhood its name is buried under a plastic liner with clay and topsoil in a fenced area that has been declared permanently off-limits. However, the EPA has declared the rest of Love Canal safe. Even though some still wonder if the area is truly safe, much of the property has been renovated and resold.

According to the Love Canal Revitalization Agency, 232 of the 239 homes have been renovated and recently sold, creating an environmentally safe neighborhood on land once contaminated. Love Canal, which symbolized hidden toxic wastelands, is now known as Black Creek Village. As a result of grass roots interest and media attention, Love Canal became a national symbol for the environmental threats the United States and the world face from hazardous waste.

In March 2004, the EPA reiterated Love Canal was clean and should be taken off Superfund list.

### SEE ALSO

water pollution; Environmental Protection Agency; hazardous waste.

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## Luxembourg

LUXEMBOURG HAS LONG been known as a tax haven. One of the major hallmarks of tax havens is a strict policy of banking secrecy. In the Grand Duchy of Luxembourg it is illegal to disclose details of banking customers unless there is strong evidence of fraud. The Grand Duchy maintains that there is no contradiction between bank secrecy, which is intended to protect the individual's privacy, and effective crime fighting.

In January 2003, European Union (EU) finance ministers in Brussels, Belgium, agreed after 14 years of negotiation to terms that were meant to level the playing field on taxes and end tax havens. The Tax Package was formally agreed to six months later. The core of the package is the Savings Tax Directive which is intended to ensure that individuals do not escape taxes by investing in other EU countries. Terms were to have gone into effect the beginning of 2004 but have been delayed for one year. Twelve of the 15 EU countries (2003) are to share non-residents' savings accounts information.

The other three, Luxembourg, Austria, and Belgium, refused to waive their banking secrecy regulations and exchange customer information. Instead, those three agreed to levy a withholding tax on savings interest. The withholdings from each of these countries is to be distributed with 25 percent going to the banking country which collected it, and 75 percent to the country of the customer, but with no

identification as to who the customer is. The three also agreed to join the information exchange only if Switzerland, which is not an EU member, drops its tradition of banking secrecy. Switzerland has agreed to join in withholding taxes on savings of EU residents.

Many scholars perceive financial centers that surround themselves with secrecy to be breeding grounds for crimes such as money laundering, as well as money sources for terrorists and other criminals. Luxembourg was among the first countries to adopt measures against money laundering in 1989. The Grand Duchy advises that it cooperates fully at the international level. A Luxembourg governmental web site says the country is an active member of FATF (Financial Action Task Force) which specializes in the fight against money laundering, and that the task force testified in its last evaluation that Luxembourg had completely respected all its recommendations.

Additionally, legislation in Luxembourg requires very strict conditions regarding access to the financial sector. This is especially true regarding the identity and worthiness of shareholders and directors of financial institutions. The law specifically demands that professionals in the financial sector know their customers. Anonymous accounts do not exist.

Luxembourg declares itself to be among the European countries which have "most completely and swiftly implemented the measures advocated by the American authorities in the fight against the financing of terrorism."

### SEE ALSO

tax evasion; Bank Secrecy Act; Switzerland; offshore entities; Securities and Exchange Commission.

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# M

## Madison Guaranty

A SAVINGS AND LOAN bank, Madison Guaranty was part of President Bill Clinton's Whitewater scandal. In June 1978, Clinton and his wife Hillary joined their longtime friends, Jim and Susan McDougal, in the purchase of 230 acres near Flip-pin along north Arkansas' White River. Their Whitewater Development Corporation was formed to build and sell homes on lots on this land. The couples borrowed about \$200,000 of the money to purchase the land from Citizens' Bank; the \$10,000 down payment was borrowed from another bank but the investors did not inform Citizens. The Clintons were equal partners in the endeavor even though they did not invest as much as the McDougal.

In January 1982, Jim McDougal, who had been Arkansas Attorney General Bill Clinton's economic aide from 1978 to 1980, bought the Woodruff Savings and Loan in Augusta, Arkansas. He changed the name to Madison Guaranty and moved it to Little Rock. In the mid-1980s, the bank was making unwise loans, and in 1984, the Federal Home Loan Bank Board issued a "highly critical exam of Madison Guaranty," The Public Broadcasting System reported.

Madison entered into a supervisory agreement to correct its lending errors. The same year the Mc-

Dougal's borrowed \$100,000 from the Madison Guaranty savings and loan (S&L) in order to pay down the Whitewater mortgage.

In April 1985, Jim McDougal held a fundraiser for Clinton, now governor after his tenure as attorney general) at the Madison Guaranty offices. An estimated \$35,000 was raised, but later there were questions whether some of the funds were provided by depositors, or were given by the bank in the names of depositors without their knowledge.

McDougal and his friend Seth Ward (who was also a Madison Guaranty subsidy executive and father-in-law of Hillary Clinton's law partner Webb Hubbell) purchased the 1,050-acre Castle Grande property for \$1.75 million in October 1985. Madison Financial, Madison Guaranty's real estate subsidiary, provided \$600,000, its legal limit, and Ward borrowed \$1.15 million for his share from Madison Guaranty in a non-recourse loan.

By the end of 1985, Madison was in trouble. Attorney Hillary Clinton represented the S&L bank and helped persuade state officials to let Madison raise funds by selling preferred stock. This unusual course was approved by Beverly Bassett, Arkansas commissioner of securities and a Clinton appointee, but was never carried out.

In February 1986, developer Dean Paul borrowed \$825,000 from Madison Guaranty to buy three properties from lender David Hale, whom

Clinton had appointed municipal judge. Hale loaned \$150,000 to Jim Guy Tucker (later governor of Arkansas) and R.D. Randolph, who borrowed another \$1.05 million from Madison Guaranty. Senator William Fulbright borrowed \$700,000 from the S&L, then with Tucker and Randolph bought the majority of the Castle Grande property. Hale's company also loaned \$300,000 to Susan McDougal's Master Marketing company; Hale said he was pressured by the governor and McDougal into approving the loan.

Jim and Susan McDougal were forced to resign from Madison Guaranty in July 1986 by the Federal Home Loan Bank Board. In 1989, Madison was taken over by the Resolution Trust Corp. (RTC), the federal agency managing the savings and loan crisis. Jim McDougal was indicted on bank fraud charges in late 1989 but acquitted by jury in 1990. The McDougals separated. Susan McDougal moved to California where she was later convicted of embezzlement. Hale was indicted on charges of defrauding the federal government with his Small Business Administration-backed loans in 1993. The S&L failure cost American taxpayers more than \$60 million.

Governor Tucker, and Jim and Susan McDougal were indicted on multiple counts of bank fraud in August 1995, tried in April 1996, and convicted a month later. Susan McDougal refused to answer questions before the grand jury and was sent to prison. After his conviction, Jim McDougal began to cooperate with the independent counsel, Robert Fiske, appointed independent counsel to investigate Whitewater in 1994; he was followed seven months later by Kenneth Starr who broadened the inquiry wide enough to encompass the impeachment of the president of the United States, Bill Clinton.

#### SEE ALSO

Whitewater; Clinton William J.; bank fraud; accounting fraud; savings and loan fraud.

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## mail fraud

THE FEDERAL MAIL fraud statute is codified under 18 USC §1341, and has two essential elements: 1) use of the United States mail; 2) use that is in furtherance of defrauding someone. The law has been utilized in diverse cases by federal prosecutors in pursuing everything from simple confidence games to bribery of public officials. §1341 has been used against virtually every new method of fraud, and sometimes has been the only way to prosecute and adequately punish sophisticated fraudsters. Despite the broad application and peculiar elements that give §1341 great prosecutorial power, those characteristics also place it in jeopardy of inappropriate and abusive usages.

Its offspring statute, wire fraud (18 USC §1343), is in almost all cases interpreted similarly to §1341. Mail fraud encompasses the use of the mails, either inter- or intrastate, whereas wire fraud outlaws the interstate use of wires for fraudulent purposes. Federal jurisdiction of both mail and wire fraud originate in the Constitution under Article 1, Section 8. However, mail fraud is based on Congress's control of the postal authorities and wire fraud is based on Congress's right to make laws affecting interstate and foreign commerce.

Mail fraud may be seen as more specific to the federal jurisdiction than wire fraud because its overt act is any use of the mails, which are owned and operated by the government, as a necessary means to complete the fraud scheme. Wire fraud, on the other hand, involves wires owned by entities other than the federal government, so federal jurisdiction is, like many federal offenses, based only on the Commerce Clause.

#### INSTRUMENTS OF CRIME

The underlying legal crime of mail fraud is not that associated with the scam, but rather the crime in using the mails, or trying to use them, as an instrument of defrauding the mail recipients. This allows extremely distinctive enforcement interpretations. First, the statute is completely unconcerned with the harm inflicted by the fraud. Second, the culpability structure of §1341 is much more inclusive than almost all other criminal offenses because the statute allows merely a "scheme" to be prosecuted, regardless of whether the scheme actually took place or was successful.

The interpretation is, in this sense, similar to a conspiracy to commit a crime, but a conspiracy necessitates at least two participants; there need be only one participant in the scheme to be prosecuted under mail fraud. Further, whereas conspiracy can be charged only once regardless of the number of separate overt acts committed as a result of the conspiracy, mail fraud law punishes each act of mailing as a separate count. Third, the intent to violate §1341 only need involve a broadly interpreted “foreseeable” use of the mails; most offenses require that the perpetrator have knowledge of the commission of the act and also intended its commission.

In 1994, Congress added to §1341 the use of common carriers to execute a fraud, and added financial institution victims in 1989. The maximum penalty for mail fraud affecting a financial institution was raised from 20 years to 30 years in 1990. The current §1341 is titled “Frauds and Swindles” and spells out the statute (albeit long-winded):

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than five years, or both.

If the violation affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

## HISTORY OF MAIL FRAUD

The two central legal questions that have dominated the history of this statute center on what constitutes the use of the mails and what constitutes fraudulent use. Prior to the Civil War, the general legal position was that the federal government had no right to open mail matter. This changed with the forerunner to the modern mail fraud statute, the “lottery law” of 1868, which made it illegal to mail any materials that involved a lottery or other similar prizes. The legal theory behind the lottery law, which is also the foundation of all subsequent mail fraud statutes, is based on the authorities first obtaining information about an illegal use of the mail and then securing a search warrant to inspect mail contents for evidence.

Given the large numbers of mail swindles during Reconstruction, there was a perceived need for federal help in combating frauds at the local level. Congress did not want the national postal system to be used as an instrument of crime and moral turpitude, so it passed the first mail fraud statute in 1872 as part of much larger legislation affecting the mails. The first section of the statute proscribed obscene and other objectionable materials, and the second section forbade lotteries. The third section, mail fraud, outlawed “having devised or intending to devise any scheme or artifice to defraud” that principally depended on the mail for execution.

The first mail fraud statute, then, projected a fairly limited conception of what is meant by the intended misuse of the mails. People were punished under the statute according to the extent “the abuse of the post-office establishment enters as an instrument into such fraudulent scheme or device.” Judicial validation of this first statute came quickly in 1877 through the Supreme Court case, *Ex Parte Jackson* (96 U.S. 727, 1878). Although Jackson came to the Court under questions about the “lottery law,” its opinion rang a sound constitutional endorsement for the mail fraud statute, finding that Congress controls the mails and that controlling the mails includes determining what will not be carried in those mails.

The most significant revision to mail fraud law took place in 1909, during the Progressive Era, and involved the major change in defining what constitutes the use of the mails to defraud. It deleted all specific language of the “instrumentality” theory requiring that the perpetrator intended to directly

misuse the mails as a necessity to the fraud. In its place, Congress worded the statute to include any use of the mails in furtherance of a fraud, regardless of whether the perpetrator sent or received mail, regardless of whether the mails were intended to be used, and regardless of whether the mails represented a central or peripheral instrument of crime in the scheme.

This statutory language exploded the number and variety of cases in which the federal government could intervene jurisdictionally, and more than anything else reflected the federal government's desire, as was characteristic of the time's Progressivism, to become involved in innumerable types of acts that had been local matters. Since 1909, incidental, or even accidental, use of the mails during a fraud scheme would be enough to fall under the law.

Going back to 1909, the wording of the mail fraud statute has caused courts to grapple with many undefined issues because it does not address the kinds of "schemes" or "artifices" to defraud that fall under its punishment; rather, it counts only the number of times the mails were used. Courts have tried to focus on whether an act of mailing was somehow necessary for the offense's fruition, and the precedents seem to focus on a matter of timing. For example, a confidence artist can be convicted of mail fraud because he waited for his check to clear before absconding, and the check cleared through the mails—waiting for the cash was seen to be a part, however small, of the fraud scheme. On the other hand, a person who embezzles monies previously received through mailed donations is not punishable for mail fraud because the use of the mails occurred before the scheme to defraud. Mailing to a credit cardholder a statement with a fraudulent charge by another person does not constitute mail fraud for the thief, because the mailing occurred after the crime. The 1909 statute considers mail fraud to be present in all cases where mails are used to carry out the scheme in any way and where such use would be foreseeable by a reasonable person.

#### SERVICES, PROPERTY RIGHTS, AND TORTS

One strongly debated legal question has been whether mail fraud can be applied to both public officials and those in private business who use the mails to further a bribery scheme. Since the 1930s, the meaning of fraudulent schemes within the mail

fraud statute was interpreted to include depriving someone of an intangible right to honest service. This interpretation eventually encompassed under mail fraud any use of the mails associated with a solicitation or acceptance of corrupt, quid pro quo bribes by private individuals and public officials.

The use of mail fraud in bribery cases was consistently upheld by various courts until 1987, when the Supreme Court decided *McNally v. U.S.* (107 S.Ct. 2875, 1987). Here, the Court broke long tradition by finding that the historical intent of §1341 did not include as fraud depriving someone of something intangible, such as a right to honest services. Instead, according to McNally, the deprivation must involve actual or intended loss of property or property rights. Eventually, the McNally reversal was applied retroactively to those previously convicted of mail-related bribery that did not involve property losses.

Congress immediately exercised its check-and-balance role by passing in 1988 a completely new statute, 18 USC §1346, which stated simply, "For the purposes of this chapter [covering mail and wire fraud], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services." §1346 was meant by Congress especially to reinstate the pre-McNally ability of federal prosecutors to go after bribery under the mail fraud and wire fraud statutes. It also tried to allow coverage of any other situation that involved deprivation of honest service using the mails or wires, including bribe-taking by a fiduciary.

The conflict over the idea of "dishonest services" among the courts, prosecutors, defendants, and Congress recurred in the allegation that the single sentence in §1346 is unconstitutionally vague because a reasonable person would not know what is meant by the statute's wording of depriving another of the intangible right to honest services. Further, there is no implication in §1346 about the circumstances in which it should be applied. At least three court-imposed restrictions have been placed on the applicability of §1346.

First, simple breaches of contract should not be considered a deprivation of honest services. Second, the focus in McNally on property rights for §1341 has been applied to §1346 through the requirement that something more than minimal economic harm to the victim must have been foreseeable by a reasonable person, if the statute's

clause of deprivation of dishonest services is to be applied. Much to the dismay of Congress, this continuation of a property emphasis into §1346 may effectively eliminate the punishment of people who use the mails or wires to further a corrupt bribery scheme, but which does not involve economic harm.

Third, §1346 has been limited to torts. This means that the only time "dishonest services" actually occur in a mail or wire fraud is through wrongful behavior causing damage and for which a person can be sued civilly. Restricting §1341 to foreseeable property loss and restricting §1346 to torts should make their enforcement considerably more clear, but numerous issues remain to be resolved about exactly what constitutes using the mails or common carriers to defraud.

#### SEE ALSO

wire fraud; direct-mail fraud; bribery; scams.

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## Major Fraud Act of 1988

SPONSORED BY U.S. Representative William Hughes from New Jersey, the Major Fraud Act (Public Law 100-700) was signed into law by President Ronald Reagan on November 11, 1988. The Major Fraud Act significantly increased the maximum penalties which could be assessed for certain major frauds committed against the United States government.

Title XVIII of the U.S. Code, primarily known as the Federal Criminal Code, was amended considerably to allow for increased penalties against anyone who knowingly and willingly commits or

attempts to commit a plan to fraudulently receive property or services from the U.S. government valued at \$1 million or more. The act increases the maximum penalty for a single count to \$1 million and for multiple counts to \$10 million. Criteria for the specified amounts of fines are set forth by the act, and fraud violators may also face prison terms of up to 10 years. The act authorizes the U.S. Sentencing Commission to come up with guidelines or to modify existing ones to better deal with frauds, especially those which have a high risk of potentially serious injuries as a possible result of the unlawful actions.

Employees who assist prosecutors with a fraud case are protected by the act if their employment is terminated or modified in a negative way as a result of the proceedings. However, in order for employees to receive this protection, they must not have acted with complicity in the fraud that was committed. If a person qualifies for this protection, the act stipulates specific remedies for adverse actions taken against employees.

The Major Fraud Act states that fraudulent contractors may not seek reimbursements for costs incurred during any fraud proceedings initiated by the federal government, or a state government, which deal with a violation or failure to comply, if the defendant is found to be guilty of the violation. The recovery of costs is permitted when the proceedings are ended by a compromise that results in an agreement between the contractor and the U.S. government. Usually, the amount which is to be reimbursed to the contractor is provided within the terms of the agreement. Also, costs may be recovered if the director of the department or agency which committed to do business with the contractor consents, under certain conditions, that the costs were covered under specific provisions within the original agreement between the contractor and the U.S. government.

In order to guarantee enforcement, the act provided for the creation of additional positions within the Department of Justice, including the addition of an assistant U.S. attorney, solely in order to investigate and prosecute fraud against the U.S. government. The U.S. attorney general is required by the act to report to Congress annually concerning statistics which record the number of referrals of fraud cases by government departments and agencies, number of investigations of contractors, number of attorneys, support, and agents utilized

in cases, and number of convictions, acquittals, sentences, reimbursements, and penalties. Since its enactment, the Major Fraud Act has been amended numerous times, including some minor and major changes. Most of the amendments deal with specific types of fraudulent activities such as credit card fraud, computer fraud, bank fraud, among other fraud crimes. The fraud crimes which are most often prosecuted are usually not violations in excess of \$1 million, but smaller violations such as false statements, false claims, and conspiracy to defraud.

Although smaller fraudulent acts are committed more frequently, violators of the Major Fraud Act are prosecuted often. For example, on February 16, 2000, Olson Electric Company of Daytona Beach, Florida, was sentenced to pay back \$885,819 to the National Aeronautics and Space Administration (NASA) and pay a special assessment fee of \$200. Olson Electric knowingly lied in official records to qualify for a NASA contract worth \$3.2 million, specified for a woman-owned small business, to refurbish a shuttle launch pad at the Kennedy Space Center in Florida. Consequently, on November 17, 1999, Olson pleaded guilty to violating the Major Fraud Act and was forced to repay the over-billed amount at the sentencing on February 16, 2000. The verdict was only one success in the Department of Justice and the U.S. attorney general's ongoing battle against major fraud.

#### SEE ALSO

government contract fraud; government procurement fraud; Justice, Department of; conspiracy.

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## maritime fraud

**COMPOSED OF** of several illegal activities, maritime fraud includes smuggling, money laundering,

documentation and insurance fraud, and the illegal transport of persons. All of these examples present unique challenges to law enforcement authorities. The last few years have seen an alarming increase in international economic fraud, and much of it takes place during maritime transport. Due to the magnitude of operations, these crimes most always involve a complex and organized criminal element.

As the demand for and profit from illicit transportation of people, consumer contraband, and illegal drugs expands, so does the criminal scope. Transportation links present an attractive opportunity for business, and large profit margins are a driving force in motivation. By utilizing violence and intimidation, an organized crime system is able to secure help at various levels of transport. Complex schemes are planned and set into motion, many of which appear similar to those used by legitimate corporations. By the same token, legitimate businesses sometimes carry on illegal activities under the guise of business as usual.

Crime syndicates, drug cartels, and ethnic groups also compete for regional controls, which are carefully chosen to exploit weaknesses in the system. Areas that suffer a decrease in governmental controls are also targeted, as are areas which have affiliations with immigrant communities. Civil disturbances and international market conditions are often exploited in an attempt to take advantage of a temporary market and to shift suspicion onto other suspects. Growth of both black market and white-collar crime has greatly expanded due to advancements made in communications and transportation technologies.

The International Maritime Bureau (IMB), established in 1981, was formed to combat all types of maritime and trade crime. Their focus is often centered on aspects of cargo theft, deviation of ships, fraudulent documentation and illegal charter. Working closely with regional law enforcement agencies, they work to reduce piracy and fraud by carefully tracking cargos and shipments, verifying scheduled arrivals at different junctures. In order to expand their effectiveness, the IMB held an international conference in Geneva, Switzerland, where it established the International Maritime Organization (IMO), which investigates suspected criminal activities.

Maritime fraud is one of the end results of piracy, or violent crimes at sea. These may result from hit-and-run raids as well as theft of vessels and



*Soaring maritime crime has created a surge in forged travel documents, both for the ship and the crew.*

cargos. The result of piracy can be commercial devastation and often includes human tragedy; the busiest shipping lanes are prime hunting grounds. Piracy has soared worldwide. Armed with advanced weaponry and high-tech equipment, such as rocket launchers and global positioning equipment, criminals have a greater chance of successfully committing their crimes. The spoils of piracy are then fraudulently documented and millions of dollars are lost as the goods are sold to unsuspecting customers or other conspirators. A focus on piracy lead to two international treaties: the 1982 Convention, which provides an international definition for piracy, and the Rome Convention, which responds to the escalation in the global threat of terrorism.

Regulations in the declaration of ship ownership promises to be a great help to law enforcement in the fight against maritime crime. Secrecy is desired for purposes of theft or tax-evasion. False information presents an additional hurdle to maritime law enforcement. The inability to detect fraudulent certificates presents tremendous opportunities for illicit activities and presents a particular haven for terrorist opportunities.

## FORGED PAPERS

The IMB reports that forged ship and crew travel documents are easily obtained, and difficult to de-

fend against. Recent investigations required the recall of several years' worth of maritime licenses and documents issued from San Juan, Puerto Rico. Hundreds of licenses contained blanks and a machine used for document printing was reported missing. Nearly 1,000 questionable mariner documents were targeted by the inspection teams and over 250 of them were confiscated. In 2001, there were 13,000 false certificates reported and it is estimated that many more went undetected. Two men were arrested; one was a formerly with the U.S. Coast Guard. The breach in maritime security was considered major.

Forgery was also evident in the majority of countries inspected. This well-organized deception required assistance from administrators, employers, manning agents, and training programs. Crimes of this magnitude must rely on participants from several layers of the organization, indicating widespread corruption.

On March 25, 2002, a new requirement was implemented was put into place which required all new ships be tagged with permanent identification numbers that are assigned by Lloyd's Registry Fairplay during ship construction. The number reads "IMO" followed by the seven-digit assigned number, which remains unchanged upon transfer of ownership. This requirement will make ownership transparent, and raises security standards by increasing the chances of prosecuting perpetrators of maritime fraud.



*The volume of container shipping across the globe makes inspecting individual containers nearly impossible.*

Another main target of maritime fraud is marine insurance underwriters who have to weigh out fictitious and legitimate insurance claims. This may take form as the intentional total loss of a vessel by the owner, or the over-insured loss of cargo. Another method used to defraud the underwriters is false documents used to substantiate such losses.

As the volume of commercial seaborne trade triples, identification of possible arms shipments becomes more difficult to detect. The demand for weapons and drugs continues to drive the black market and tempts those with access to the area. Violence and conflict stemming from ethnic or religious differences are prime business opportunities for criminal activity. The best laid criminal plans intermingle illicit cargo among the legitimate. Because the high success rate for fraudulent transport, more legitimate business people are lured by the desire of easy money, taking advantage of the confusion caused by jurisdiction differences.

On September 5, 2003, six Pacific Rim countries agreed to conduct joint maritime exercises for the following year in a united front to discourage the escalation of criminal activities. The maritime police in these areas are working to eradicate the crimes of piracy, smuggling, terrorism, and money laundering.

Compulsory disclosure of ship ownership, increased scrutiny of shipping documents, and amendments to international conventions to clarify links between vessels and flag states, can improve the efficiency of maritime law enforcement and provide a tighter security for the world at large. But an ongoing need will be for cutting-edge technology to combat the new complexities of maritime fraud.

#### SEE ALSO

drug trafficking; human trafficking; organized crime; forgery; globalization; money laundering.

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## market manipulation

IN THE FALL of 2002, two international firms made headlines in the United States for their involvement in market manipulation. Specifically, Enron Corporation and Tyco International were charged with artificially inflating the value of their firms' respective stock. For example, the Federal Energy Regulatory Commission found that Enron had manipulated the price of its stock and hid the related transactions. There were several other large firms also charged in this time period, culminating in several task forces, commissions, reports, media coverage and ultimately resulting in structural reforms.

Manipulation has been formally defined by *Blacks' Law Dictionary*: "A series of transactions involving the buying or selling of a security for the purpose of creating a false or misleading appearance of active trading or to raise or depress the price to induce the purchase or sale by others."

Brokers who have a stake in a particular stock might be inclined to make misleading or false assertions to prospective clients. Often, this is done in order to create the impression that the price of a stock is soon to rise, and thereby such actions create an artificial demand for it (artificial inflation). There are many ways broker-dealers manipulate markets (upward or downward). Most frequently, market manipulation involves a brokerage firm purchasing large volumes of stock in a small (or sham) company that is frequently owned by the brokerage firm itself. The brokerage firm, which owns the overwhelming majority of shares, drives up the worthless stock by "cold-calling" scores of unsuspecting investors (often senior citizens). At some predetermined point (that is, price), the brokerage firms' insiders dump their shares, leaving the public with worthless stocks and the brokers with millions in ill-gotten gains. Though market manipulation can take place in virtually any securities exchange, it takes place most commonly in the penny-stock industry.

In general, penny stocks are considered those securities not listed on a recognized exchange, hence they are traded over-the-counter (OTC), and information about them is only available on the "pink sheets." Pink sheets refer to a weekly list of firms trading in over-the-counter stocks along with their price quotes on securities. The National Quotation Bureau, a private firm publishes the list, which is



printed on pink paper. With respect to market manipulation, there is a key reason offenders target the pink sheets and the OTC market—lack of serious regulations.

For example, to get onto the National Association of Securities Dealers Automated Quotation System (NASDAQ), a company is required to have a minimum of several millions of dollars in assets and just slightly less in shareholders' equity. Perhaps more importantly, for a stock to be listed on NASDAQ it must have at least two market makers (a market maker is a broker-dealer that regularly buys and sells a particular security).

The reason for this should be obvious: a single market maker can, with ease and virtual impunity, illegally manipulate a security's price. Pink-sheet firms and the stocks they trade are only required to be registered with the Securities and Exchange Commission (SEC). NASDAQ securities average nine market makers per security, thus promoting competitiveness, while the pink sheet stocks typically have only one.

Thus, pink sheet firms are thought by a proportion of analysts and examiners to represent the true bottom-feeders of the securities world. Penny-stock market manipulations such as those above are frequently referred to as "pump-and-dump" schemes, and they are often run out of "boiler rooms," fake or temporary offices.

The contemporary penny-stock boiler room depends upon a large work force of telephone solicitors who are often deliberately chosen for their lack of experience in, and knowledge of, the securities industry. Many, in fact, quickly leave once they realize they are part of a criminal enterprise. Boiler rooms are run by energetic managers whose sole responsibility is to keep their sales representatives relentlessly on task, snaring unsophisticated people, and talking them into giving them money for nothing but a "dream," as one former stock scammer and boiler-room employee stated.

It is the relentless pressure by the managers on the callers-solicitors, and theirs, in turn, on the unsophisticated credulous public that is at the heart of the penny-stock swindle. Some of these criminal penny-stock boiler rooms gained infamy for their flamboyance. Stratton Oakmont, for example, was headed by Jordan Ross Belfort and Daniel Mark Porush and located in Lake Success, New York. The firm gained notoriety for its motto: "Never hang up the phone until the customer buys or dies." An-

other firm became the premise for the 2000 film *Boiler Room*, while several other real-life scenarios were portrayed in the popular HBO series *The Sopranos*.

Market manipulation, particularly in unregulated markets such as the pink sheets, is fairly simplistic. Successful manipulation schemes, such as those that wind up as news headlines and subplots for the mass media, require the artful assistance of accountants (to shield the scammer from regulatory bodies, hide money from investors and regulators), lawyers (to fend off regulatory, civil and criminal attacks, public relations), clearing firms (to provide guise of credibility) and banks (to house illicit proceeds). Thus, these are commonly organized criminal conspiracies in the truest sense.

#### SEE ALSO

securities fraud; National Association of Securities Dealers; stock fraud; telemarketing fraud.

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## marketing fraud

**MARKETING RELATES** to all those functions relating to the creation, promotion, distribution and sale of goods and services for which there is a de-

mand and on which a profit can be made. As a result, a wide range of business functions have a marketing component, particularly in the current business environment in which the marketing component of the value of finished goods and services increasingly takes a higher proportion as production costs decrease, as techniques improve. As a result, a very wide range of fraudulent opportunities are provided by the marketing process. However, it is more commonly understood that marketing fraud relates specifically to the failure to keep promises with the consumer and the hiding of negative consequences of consuming a product.

This form of behavior has become proverbial with the selling of snake oil and has been practiced for thousands of years. More recently, new technology, including the internet, has been used to multiply the effectiveness of such marketing frauds. An example is the cross-border telephone frauds involving Canadian and U.S. firms and individuals. These involve approximately 500 to 1,000 telephone "boiler rooms" (fake or temporary offices) in Canada offering fraudulent deals on credit cards, loan offers, and lottery prizes.

This industry may be grossing around \$1 billion daily. These types of fraud have become characterized by rapidly increasing sophistication of methods, high levels of security and advanced processes of money transfer and laundering. In response to the jurisdictional difficulties involved in cross-border crime, states are creating bilateral and multilateral agreements to find new ways to monitor and regulate these activities.

Some examples of fraud result from, in part at least, ideological or political differences. For example, the United Kingdom Vegan Society is strongly opposed to the use of animals in producing food, and has produced literature based on research in which they claim that such food is unnecessary for nourishment, and the process is cruel to the animals. Hence, those involved in the dairy foods market are committing frauds on the public to persuade them they need these products. These claims of course are denied by the dairy and beef industries. Similar issues bedevil sectors related to genetically modified organisms (GMOs), about a number of contested claims have been made without incontrovertible scientific proof either way.

Another area of growing fraud involves companies apparently specializing in complex business and legal operations, who obtain money from cus-

tomers but do not provide the services specified either at all or else in a substandard manner. One particular example of this is in advice and consultancy relating to patents and the protection of intellectual property. As this is a complex and continually changing field, the hopeful inventors are often eager to receive what they believe to be impartial and professional advice to support what has often been many hours of unpaid work on their part.

## INTERNET FRAUDS

The increasing penetration of the internet has given rise to a variety of marketing fraud opportunities. The internet provides contact to large numbers of people through e-mail at a low cost. The anonymity provided by an online persona may be quite distinct from that of real-life situation where acts of selfishness and greed would be unconscionable in face-to-face dealings. These factors have ensured the internet as fertile ground for fraud. Four areas in particular have proved to be particularly problematic:

*Making false claims with a view to obtaining the money of the victim:* very well-known examples of this phenomenon include the mass e-mailing of letters purporting to be from individuals who have obtained very large sums of money through semi-legal or dangerous means. Commonly, the mailer claims to be the beneficiary of a rich individual in a country such as Nigeria, which is known for its high levels of corruption and inequitable distribution of wealth. The mailer claims to be looking for honest individuals able to assist in the cross-border transfer of sums of money amounting to many millions of dollars. The intended victim is requested to supply bank details and a handling fee which is then stolen by the fraudster, and the bank details are used to extract additional funds from the victim. In some cases, the interaction between fraudster and victim can become long-term.

*Selling fake or substandard goods through mass e-mailing:* One noted example of this has been the exploitation of public concern over the high costs of many prescription drugs by offering low cost supplies, often of sexual stimulants such as viagra about which people often feel reluctance to purchase openly.

*Credit card and identity theft:* sophisticated software is now able to be used to sift through many millions of communications to obtain, albeit in

fragmentary form, personal details such as credit card account numbers. As online credit card transactions do not need the customer's signature, it is quite easy for people who have obtained these details to use them fraudulently to obtain goods and services.

*Click-through schemes (also known as affiliate fraud)*: the click-through programs that at one stage seemed likely to dominate successful business models on the internet may be considered dishonest rather than fraudulent. They occupy one of the many areas in which technological development has leapt ahead of the ability of legislators to regulate efficiently, especially when dealing with an international context. In these schemes, website operators pay search engine companies a certain amount of money each time their site is listed as the result of an internet search and whenever any person clicks the link to their site as a result of that prompt. In the case of search terms with high money-making potential and intensive competition, such as home loans, online gambling, or web hosting, a single click-through referral may be worth \$10 or more. Stakeholders in companies providing this service therefore have a significant incentive to use the service themselves and click-through to their customers' websites. As a result, a large proportion of hits recorded by the website may simply be the result of stakeholders artificially boosting the amount they must pay.

Other forms of marketing fraud may use the internet tangentially or else variations of the techniques developed in its context. For example, a recent series of high-quality frauds in the United Kingdom has featured cold-calling people with schemes based on investing in art, which either does not exist or else is valued much lower than advertised. These schemes may feature a supporting website supposedly offering endorsements of the products offered and even newspaper and magazine advertisements.

#### SEE ALSO

advertising fraud; internet fraud; Justice, Department of. bait-and-switch; scams.

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## Maxwell, Robert (1923–1991)

ROBERT MAXWELL was born Jan Ludvik Hoch in a small town on the Czechoslovakian border, to peasant parents who became victims of Adolf Hitler's holocaust during World War II. The fact that Maxwell rose from having nothing to heading up an international financial empire that encompassed publishing interests, television and cable stations, recording companies, and language schools affected most decisions he made throughout his life. Maxwell established a reputation as a user and abuser of people who frequently manipulated his own truths.

#### PUBLISHER EXTRAORDINAIRE

Many of Maxwell's critics were afraid to criticize him because he was known for bringing libel suits against those whom he thought defamed him. By all accounts, Maxwell relished being called "publisher extraordinaire" and delighted in his international acclaim. On one occasion, Maxwell approved a magazine layout that showed him with a halo superimposed on an existing photo-portrait. While Maxwell may have been an extraordinary publisher and financier, he was far from being an angel.

In 1951, Maxwell purchased Pergamon Press, which published textbooks and scientific journals, for £13,000. In 1969, questions arose over a failed attempt to sell Pergamon to Leasco, an American finance group, leading to a major investigation of both Maxwell and Pergamon. Investigators, who included the well-known accounting firm Price-Waterhouse, discovered that as head of Pergamon, Maxwell had manipulated financial records to hide the fact that most of Pergamon's profits were dependent on transactions with private companies owned by the Maxwell family. Price-Waterhouse reported that Pergamon's 1968 profits of £2.1 million had been over-reported by £1.6 million. In 1973, a no-holds-barred report issued by Britain's Depart-

ment of Trade and Industry (DTI) made it clear that “notwithstanding Mr. Maxwell’s acknowledged abilities and energy, he is not in our opinion a person who can be relied on to exercise proper stewardship of a publicly quoted company.” Maxwell subsequently lost control of Pergamon but repurchased it in 1974 and continued to head the company until 1991 when he sold both Pergamon and Maxwell Directories for £440 million to Elsevier, a transnational publisher.

#### PRIME MINISTER MAXWELL

As part of his campaign to become prime minister of Great Britain, Maxwell ran for a Buckinghamshire seat in the House of Commons on the Labor Party ticket in 1964. For the next six years, Maxwell stirred up a number of controversies that led to various charges of dishonesty and deceit. For instance, in 1966, Maxwell surprisingly agreed to serve as chair of the House of Commons Catering Committee to determine why the commons kitchen had an overdraft of £53,000. Maxwell immediately fired the staff, reduced the quality of food, and sold off the entire contents of the House of Commons wine cellar. Afterwards, Maxwell claimed that he had earned a profit of £20,000 for the commons kitchen. Other committee members disagreed, claiming that Maxwell had manipulated records to hide the fact that he had actually increased the deficit to £57,000 within his four years at the helm. After being censured by the English High Court for his part in the Pergamon scandal, Maxwell decided not to run for re-election and gave up his dream of becoming prime minister.

In 1980, Maxwell took over the ailing British Printing Corporation, which he renamed the Maxwell Communications Corporation. In 1984, Maxwell purchased Mirror Group Newspapers (MGN), owners of the British tabloid *The Daily Mirror*, from Reed International. Maxwell chaired MGN until November 1991. Earlier that year, he had floated MGN as a public company in an effort to raise cash to avoid filing for bankruptcy because other Maxwell enterprises had amassed debts of over £2 billion. In 1988, Maxwell bought Macmillan Publishing Co., an established American publishing company and continued as chairman and chief executive officer until 1991.

In November 1991, Maxwell died aboard his yacht under mysterious circumstances that have

never been explained, although many people believe that he committed suicide. On November 5, his body was found floating off the Canary Islands. In 1997, Ghislaine Maxwell, the youngest of Maxwell’s nine children, told *Hello* magazine that she believed her father had been murdered.

After Maxwell’s death, investigators discovered that lenders and shareholders in his various enterprises had lost around \$3 billion. Subsequently, a report issued by Britain’s DTI, which had conducted a nine-year investigation at a cost of over £8 million, revealed that Maxwell had bilked more than 30,000 Maxwell pensioners of £400 million by using employee retirement funds to manipulate the stock market to rescue various Maxwell enterprises from bankruptcy.

In 1995, Britain’s Serious Fraud Office brought Maxwell’s sons Kevin and Ian, and Larry Trachtenberg, a Maxwell financial adviser, to trial after charging them with misusing the pension funds of Maxwell employees and assisting Maxwell in risking employee funds by channeling them into other Maxwell companies. All three were acquitted in February 1996. The report by the Department of Trade and Industry stated that Kevin Maxwell bore “heavy responsibility” for the diversion of funds. Kevin Maxwell subsequently filed for bankruptcy, claiming that he was \$610,000 in debt, although he continued to live in luxury. In addition to Kevin and Ian Maxwell and Larry Trachtenberg, various investment bankers and accountants were also faulted for their parts in the pensioners’ scandal. Goldman Sachs and Coopers and Lybrand investment brokers were among those who paid a share of the £267 million settlement negotiated in February 1995, along with a £100 million payout by the British government to help rescue the retirement funds of the victimized pensioners.

A month after Maxwell’s death in November 1991, the New York *Daily News*, which Maxwell had purchased earlier in the year, filed for bankruptcy. Three years later, it was revealed in bankruptcy proceedings that Maxwell’s purchase of the failing *Daily News* had been motivated by his need to launder money so that he could show a legitimate source of income for the huge sums that were being invested or channeled into other Maxwell enterprises. The bankruptcy judge accused Maxwell of fraud, misappropriation of funds, deceit, and unchecked self-interest during the time that he owned and operated the *Daily News*. Records re-

vealed that within nine months, Maxwell had channeled \$238 million through the newspaper, even though the newspaper's finances were so fragile that suppliers sometimes refused to deliver essentials such as newsprint.

Approximately 1,800 claims were filed against the *Daily News* after Maxwell's death, and *Daily News* employees were still owed around \$1 million. In 1993, Mortimer Zuckerman purchased the newspaper for \$26 million through the bankruptcy court.

#### SEE ALSO

money laundering; board of directors.

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## Meat Inspection Act of 1906

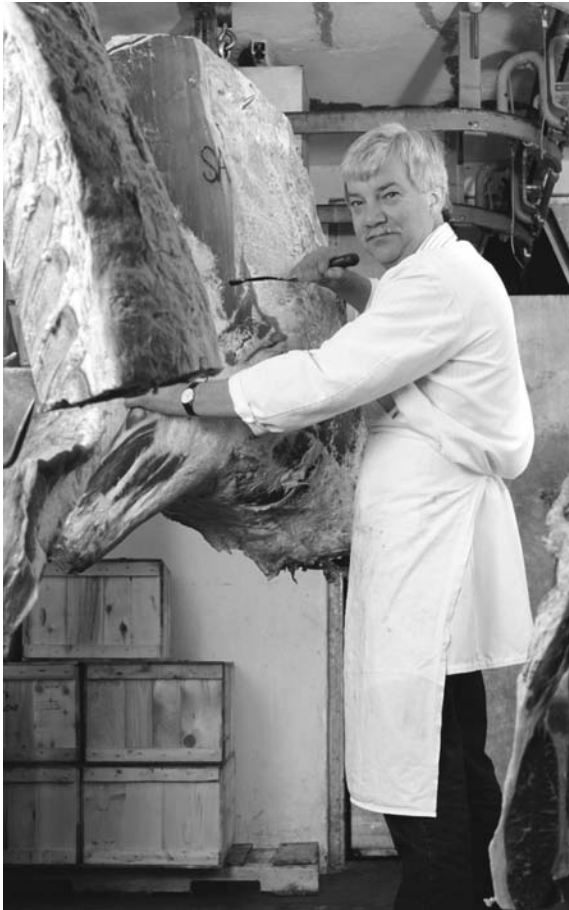
**SIGNED INTO LAW** by President Theodore Roosevelt on June 30, 1906, the Federal Meat Inspection Act enacted sweeping reform of the meat packing industry, mandating that the U.S. Department of Agriculture (USDA) inspect all cattle, swine, sheep, goats, and horses both before and after they are slaughtered and processed into products for human consumption. The act prohibits the sale of adulterated or misbranded livestock and products as food and ensures that livestock and products are slaughtered and processed under sanitary conditions. The act applies to livestock and products within the United States as well as imports, which must be inspected under equivalent foreign inspection standards.

The 1906 legislation amended prior Meat Inspection Acts of 1890 and 1891 and other laws

passed in 1897 that had provided for USDA inspection of slaughtered animals and meat products, but had proven ineffective in regulating many unsafe and unsanitary practices by the meat packing industry, also known as the Beef Trust. Beginning in the 1880s, Harvey W. Wiley, chief of the Bureau of Chemistry of the Department of Agriculture, had issued reports noting the health hazards posed by the adulteration of processed foods such as canned meat and the chemicals used as preservatives and coloring agents. The Association of Official Agricultural Chemists (an organization founded by Wiley) began a lobbying effort in favor of federal legislation governing the packing and purity of food products.

The first widespread public attention to the unsafe practices of the meatpacking industry was in 1898, when the press reported that Armour & Co. had supplied tons of rotten canned beef to the U.S. Army in Cuba during the Spanish-American War. The meat had been packed in tins along with a visible layer of boric acid that acted as a preservative and masked the stench of the rotten meat. Troops who consumed the meat fell ill, leaving them unfit for combat, and some died. Roosevelt, who served in Cuba as a colonel, testified in 1899 that he would as soon have eaten his old hat. Other soldiers and officers testified as well.

The canned meat scandal prompted Thomas F. Dolan, a former superintendent for Armour & Co., to sign an affidavit noting the ineffectiveness of government inspectors and stating that the company's common practice was to pack and sell "carriion." The *New York Journal* published Dolan's statement on March 4, 1899. Several states subsequently passed laws regulating the purity of food products, and the Senate formed the Pure-Food Investigating Committee that held hearings in Chicago, Washington, D.C., and New York City from 1899 to 1900. The committee declared such common meat preservatives as borax, salicylic acid, and formaldehyde to be "unwholesome," but lacked convincing evidence that these preservatives or other additives and coloring agents were actually harmful to human health. The press also reported from the committee's hearings that as much as 15 to 20 percent of the nation's food supply was adulterated—made impure by the addition of foreign or inferior substances. These concerns were in addition to the health problems posed by the packaging of substandard or condemned meat products.



*Progressive journalists and activists called public attention to the meatpacking industry in the early 1900s.*

At the center of public outrage were the Beef Trust and its base of meatpacking houses in Chicago's Packingtown. Journalists published pieces in radical and muckraking magazines, detailing the monopolistic and exploitive practices of Beef Trust businesses as well as the unsanitary conditions of the packing houses, and their tactics to evade minimal government inspection of animals and meat products. Of these journalists, Charles Edward Russell is perhaps best known for his series of articles about the Beef Trust that was published as a collection entitled *The Greatest Trust in the World* (1905).

The broadest public attention to the Chicago meatpacking houses came with the work of Upton Sinclair. In 1904, Sinclair covered a labor strike at Chicago's Union Stockyards for the Socialist news-

paper *Appeal to Reason* and proposed that he spend a year in Chicago to write an expose of the Beef Trust's exploitation of workers. The result was Sinclair's best-known novel, *The Jungle* (1906). The novel first appeared serially in the *Appeal* beginning February 25, 1905, and was first published as a novel by Doubleday, Page a year later, after an independent investigation confirmed Sinclair's depiction of the meat packing houses.

*The Jungle* depicts the struggle of the fictional Lithuanian immigrant Jurgis Rudkus working in a Chicago meatpacking house. Sinclair's primary purpose with the novel was to demonstrate how the corruption and greed of American industry was destroying the lives of workers, but in so doing he rendered vivid descriptions of not only the working conditions of meatpacking houses, but also the horrific meatpacking practices that produced the food itself. Sinclair described in detail the slaughtering of diseased and dead animals, the packing of rotten meat, rats, and rat feces inadvertently adulterating the meat products, the absence of government inspectors during night-time processing, bribery of government inspectors, the debilitating effects of chemicals and dangerous working conditions on workers, and even the bodies of dead workers included in the final meat products.

Roosevelt, an avowed "trustbuster," was sent an advance copy of *The Jungle* and upon reading it initiated a full investigation of the Beef Trust's meatpacking practices. The novel was an instant international bestseller and prompted massive public outrage. It is worth noting that Sinclair had intended to promote Socialism as a solution to industrial ills, but readers responded primarily to the issues of sanitation and food contamination. Also contributing significantly to the broad public response was the larger movement of muckraking Progressive journalists and activists calling for reform in government regulation of industry. There also was growing support within the industry for regulation in response to heightened public awareness.

By early 1906, the Meat Inspection Act and the Pure Food and Drug Act had both long been stalled in Congress, but when the report of Labor Commissioner Charles P. Neill and social worker James Bronson Reynolds had fully confirmed Sinclair's charges, Roosevelt used the threat of disclosing its contents to speed along the passage of both acts, which both went into law on the same day.

## SEE ALSO

Sinclair, Upton; Food and Drug Administration; Pure Food and Drug Act; Roosevelt, Theodore.

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## medical malpractice

THE ISSUE OF medical malpractice has been a hot-button issue for politicians at both the federal and state levels since the mid-1970s. Liberals insist that plaintiffs who suffer at the hands of incompetent or neglectful medical personnel should be allowed to recover full damages, that unrestricted damages serve to promote accountability among the medical profession, and that juries should be free to respond to cases on an individual basis.

Conservatives counter with the claim that too many medical lawsuits are frivolous, that juries are more likely to favor plaintiffs than defendants, and that large jury awards are detrimental to business interests. Neither side contests the reality of the problems that exorbitant medical malpractice insurance rates have caused for the medical community, and both sides take it as given that rates for medical malpractice insurance will rise in relation to the amount of damages awarded in medical malpractice lawsuits.

In medical malpractice cases, the assumption is that a doctor, nurse, hospital, mental health professional, or other medical personnel has committed a wrongful act. In some cases, the plaintiff is able to prove negligence on the part of medical personnel through documenting that an act, a refusal to act, or a breach of duty resulted in injury. Other malpractice suits are brought on the grounds that a procedure was performed without the informed consent

of the patient or the patients authorized representative or that a patient was abandoned before the professional relationship was terminated. An incident in which a patient’s right to privacy is breached by releasing medical records to unauthorized third parties may also constitute grounds for medical malpractice. Patients may also file a breach of conduct malpractice lawsuit if a medical practitioner promises a certain result but does not produce it. For example, a botched nose surgery by a plastic surgeon could provide grounds for a breach of conduct malpractice suit.

The burden of proof in a medical malpractice suit is always on the plaintiff, and the plaintiff must show a clear relationship between the action of the medical practitioner and the damage suffered. Two tests are frequently used to document cause and effect in medical malpractice suits: The “but for” test must establish that the injury to the patient would not have happened but for the actions of the medical practitioner.

The “substantial factor” test is used to show that the defendant’s actions were substantially responsible for the injury to the patient. The plaintiff’s lawyer may call on expert witness to explain the normal course of care for a particular patient and how that care was violated in some way. The expert witness is also used to document the extent of a patient’s injury.

Damages may be awarded in three categories: compensatory damages, punitive damages, and nominal damages. Compensatory damages are based on actual harm suffered, medical expenses, lost earnings, and pain and suffering. Punitive damages are aimed at punishing reckless, grossly negligent, or intentional actions that cause damage. Nominal damages are awarded to show that a patient had a legitimate complaint but that no substantive damages were inflicted.

A number of people accept what is called the “deep pocket theory,” arguing that physicians are overpaid. As a result, they see no problem with huge medical malpractice awards or with high medical malpractice insurance rates. Yet, few people deny that a crisis exists when doctors refuse to deliver babies or when they refrain from performing risky operations for fear of being sued. A crisis also exists when whole communities suffer because they have been left without doctors because of the enormous costs involved in providing medical services

to a country where citizens believe they have a constitutional right to sue over any injustice either real or perceived.

Malpractice reform continues to be the top priority for the American Medical Association (AMA). The AMA cites the disparity of jury awards, which vary from a few thousand dollars to several million dollars, as evidence that a cap on non-economic awards would promote more equitable treatment of the medical profession in malpractice lawsuits. In addition to jury awards, the defendant in a medical malpractice lawsuit spends an average of \$25,000 in legal fees.

### MALPRACTICE CASES

The issue of how medical malpractice insurance rates can affect an entire community is illustrated by the situation in which 10 Washington state neurosurgeons found themselves. The 10 physicians, who had formed Neurological Consultants of Washington in an effort to meet the rising malpractice costs, saw their rates increase from \$21,000 a year in 1998 to \$54,000 a few years later. Subsequently, their insurance carrier informed Neurological Consultants that they were uninsurable because of the high risks involved in neurosurgery and the large number of malpractice lawsuits that had been filed. With no insurance, the group was forced to cancel all scheduled surgery and refused to see new patients, leaving one large Washington hospital with only one neurosurgeon on call. Under a new carrier, the cost of medical malpractice insurance for the group was \$133,000 a year.

The story of 17-year-old Jesica Santillan, on the other hand, provides support for the claims that medical malpractice is essential, and that juries need the option of awarding damages based on the facts of a particular case. Jesica's parents braved an illegal crossing into the United States from Mexico to receive a heart-lung transplant at Duke University in North Carolina. Jesica died because her surgeon failed to check her blood type against that of the donor. The physician admitted his mistake, and Duke accepted responsibility for the lack of cross-checks that could have saved the teenager's life.

It has been estimated that each year from 44,000 to 88,000 patients die in hospitals from medical negligence of some kind. The Harvard Medical Practice Study placed the total number of deaths, which includes those that take place outside of hos-

pitals, at 180,000 people a year. According to the Association for Responsible Medicine (ARM), approximately 1 million people a year suffer injuries in response to medical mistakes. Even though studies show that doctors who make one serious mistake are more likely to commit others, most doctors who are found culpable in medical malpractice suits retain their licenses and their hospital privileges. The majority of medical mistakes are never reported, and most state laws prohibit release of this information to patients and their families who are involved in medical malpractice litigation, or to the general public.

The AMA has a powerful lobby, making the group a significant force in medical malpractice legislation. The AMA has been successful in shortening the statute of limitations for medical malpractice suits, limiting damages awarded by juries, and placing caps on legal fees for lawyers involved in malpractice suits. In March 2003, the House of Representatives passed the Medical Malpractice Awards Cap, the Republican-supported bill that placed a limit of \$250,000 on jury awards for pain and suffering. In July 2003, the bill failed by one vote in the Senate. Republicans threatened Democrats with making the failure to pass the tort reform supported by President George W. Bush a campaign issue in 2004.

The failure of such tort reform is partly due to the influence of the National Conference of States Legislatures (NCSL) which believes that the bill would amount to federal interference in matters traditionally allotted to states. The American Bar Association (ABA) also opposed the bill, arguing that it would unfairly limit the rights of individuals to be compensated for non-economic suffering. The ABA also feels that the cap would have little if any effect on the overall costs of health care.

### SEE ALSO

healthcare fraud; Medicare and Medicaid; negligence.

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## Medicaid and Medicare fraud

IN 1965, the Medicaid and Medicare programs were created in order to provide structured government mechanisms that would provide healthcare to the poor and elderly. Medicaid exists at the state level to provide healthcare to those who are unable to afford it. In all, over 36 million individuals receive healthcare through Medicaid. Medicare exists at the federal level to provide healthcare primarily to those 65 years of age and above, but also to vulnerable adults. Medicare is divided into Part A (providing hospital insurance) and Part B (providing medical insurance). Over 39 million individuals receive healthcare through Medicare.

When first created, there were no provisions for guarding against abusive activities, primarily because no one thought providers would defraud the healthcare systems. About 10 years after the programs developed, policy makers and legislators realized that the systems were being defrauded on a routine basis. To combat Medicaid fraud, many states began to develop Medicaid Fraud Control Units, which were given jurisdiction over fraud cases occurring at the state level. At the federal level, the Office of Inspector General in the Department of Health and Human Services maintained jurisdiction over the fraudulent and abusive activities.

Estimates suggest that 10 to 40 percent of the healthcare budget may be lost to fraudulent activities each year. In dollar terms, this means that billions are lost annually to criminal actions by fraudulent providers. It is important to note that a distinction exists between Medicaid/Medicare fraud and Medicaid/Medicare abuse. Fraud generally refers to instances where a provider intention-

ally steals from the healthcare system, while abuse refers to instances where the providers accidentally or unintentionally misuse the insurance systems. These distinctions are recognized in various state laws. Here's how the state of Florida, for instance, distinguishes between the two activities:

Fraud is an intentional deception or misrepresentation made by a person with the knowledge that the deception results in unauthorized benefit to himself or another person. The term includes any act that constitutes fraud under applicable federal or state law. Abuse involves provider practices that are inconsistent with generally accepted business or medical practices and that result in an unnecessary cost to the Medicaid program or in reimbursement for goods or services that are not medically necessary or that fail to meet professionally recognized standards for healthcare.

The types of fraud can be discussed according to the occupations in which they are committed. In general, the three types of Medicaid/Medicare fraud that have been seen as rampant at one time or another include physician fraud, prescription fraud, and home healthcare fraud.

### PHYSICIAN FRAUD

When public concern first surfaced about Medicaid/Medicare fraud, attention was directed toward activities by physicians, including doctors, dentists, psychologists, and other providers with practices in medicine. In the field of criminology, a host of researchers at the University of California, Irvine, were the first to discuss fraudulent activities by these medical professionals. Their research focused on the types of fraudulent acts committed, the system's response, and their causes. Researchers agree that several specific types of Medicaid/Medicare fraud have been committed by doctors. Fee-for-service reimbursement includes situations where providers bill Medicare or Medicaid for services that the client never received.

This is believed to be one of the more common types of fraud committed, or at least uncovered. It is easy to establish that a service was never provided. Some providers have been known to bill for medical tests or supplies that were never provided in a routine basis.

Pingponging entails instances where providers recommend that patients seek additional services from other providers when those additional services are not needed. This type of fraud generally involves several providers working in concert with one another. It is a little more difficult to establish than fee-for-service reimbursement because services are being provided, but it is not clear whether those services are needed.

Upgrading entails situations where providers submit bills to Medicare or Medicaid for services that were more expensive than the services that were actually provided. Consider cases where dentists bill Medicaid for expensive fillings when they actually put in the cheapest filling possible.

Double-billing fraud entails instances where the provider bills more than one insurance company for the same services. There have even been instances when providers have billed patients and Medicare and Medicaid.

Finally, unnecessary surgery entails circumstances where unneeded surgery is performed on the victim. J. Reiman (1998) cites figures suggesting that 15,000 people die each year as a result of unnecessary surgeries. These unnecessary operations, he suggests, cost up to \$4.8 billion each year. Again, the problem that comes up is that medical professionals vary in their determinations about what is necessary and unnecessary. Just as two auto mechanics may disagree on the appropriate way to maintain an automobile, two surgeons may disagree about the appropriateness of surgery.

Studies show that psychologists and psychiatrists are somewhat over-represented in terms of fraud allegations. The explanation for this disparity lies in the ways healthcare is delivered and billed for by different medical professionals. When patients visit physicians, they are often unaware of the services they received. Consequently, it is difficult for investigators to determine if the medical bills were submitted improperly. When patients visit psychologists, the provider bills for time. It is easy for investigators to ask patients how long their professional spent with them. If the patient says the provider only spent five minutes with her, and the provider billed for an entire hour, then a crime has occurred.

## PRESCRIPTION FRAUD

In the mid- to late 1980s, the healthcare field witnessed what was in effect a "war on physician

fraud." Investigations and prosecutions of these cases occurred more regularly than at any other time. In the early 1990s, the healthcare field witnessed a "war on prescription fraud." In addition to focusing on physician fraud, investigators and prosecutors began to target pharmacists, who were up until then, regularly cited in public opinion polls as one of the most trusted professions.

Several different varieties of prescription fraud exist. Generic drug substitution involves circumstances where pharmacists provide a generic drug but bill for a more expensive drug. This is especially easy to get away with because patients usually could not tell the difference between the two drugs. It would be as if someone paid for an expensive brand of gasoline, but actually received the lowest grade possible. How could they tell?

While easy to commit, this act is actually easy to catch through undercover sting operations, which were common in states such as New York and Massachusetts in the early 1990s. An off-duty police officer would take a prescription to a pharmacist, have it filled, and then the fraud control investigators would receive the filled prescription and wait for the bill to be submitted to Medicaid or Medicare. Once submitted, the investigator would be able to compare the drug in the prescription bottle with the drug on the bill. If they were different, then generic drug substitution may have occurred.

Short-counting occurs when a pharmacist bills Medicare or Medicaid for the amount prescribed by the doctor but provides less medicine to the patient. This fraud can also be somewhat easy to commit. Most people do not take their prescriptions home and count them. Those who do, will usually only alert the pharmacist if they have not received enough of their medicine. The pharmacist, then, excuses the short billing as an accident. As with generic drug substitution, undercover operations have alerted authorities to these practices.

Double-billing involves situations where pharmacists bill more than one insurance company for the same prescription (in the same way that doctors do it). Billing for nonexistent prescriptions involves billing for prescriptions that were never provided to the patient. Some billing for nonexistent prescription schemes have been quite complex, and administered as part of organized crime rings. In these cases, a pharmacist will hire drug addicts to go to the doctor and get a prescription for some fake ailment. The addict takes the prescription to the phar-

macist and the pharmacist, rather than filling the prescription, gives the addict a small amount of cash or a couple of pills of codeine. The pharmacist will then bill Medicaid or Medicare for that prescription as if it were filled. Some of these schemes uncovered by authorities netted offenders over \$1 million.

Altering the prescription is an example of forgery. In these cases, pharmacists may be involved in self-prescribing drugs. Believing that they are aware of all of a certain drugs' effects, and their own medical needs, a handful of pharmacists have been known to fill out their own prescriptions.

Finally, over-billing occurs when a pharmacist charges Medicare or Medicaid more than regulations permit. This occurs when fraudulent pharmacists find ways to overcharge Medicare or Medicaid, or the patient. Tight restrictions on allowable charges minimize the ability of pharmacists to commit this act.

## HOME HEALTHCARE FRAUD

In the mid-1990s, the federal government expanded its focus on fraudulent healthcare providers to include home healthcare fraud. As an industry, home healthcare grew significantly in the 1980s and 1990s. Technological advances coupled with a higher number of elderly persons in society contributed to home healthcare's expansion. The unbridled growth included a number of home healthcare providers who found ways to dupe Medicare and Medicaid out of billions of dollars.

Federal authorities increased their investigations, and uncovered numerous examples of fraud. In *Crime in the Home Healthcare Field* (2003), Brian Payne points out that between 1987 and 1993, just 23 cases of home health fraud were described in the official publication of Medicaid Fraud Control Units. Between 1993 and 2000, more than 273 cases were cited in this same report. The kinds of cases uncovered by the fraud control units included the following: the provision of unnecessary services, billing for services not provided, overcharging, forgery, negative charting, substitute providers, double-billing, and kickbacks.

The provision of unnecessary services entails instances where home healthcare providers provide services which were unwarranted, but billed Medicare or Medicaid for those services. According to Medicare regulations, for a service to be neces-

sary, four criteria must be present: 1) the patient must be homebound; 2) the patient must be under a physician's care with a signed care plan; 3) the patient must need intermittent or part-time skilled nursing or therapy; 4) the services must be provided by a Medicare-certified agency. If any of these conditions are not present and the provider bills Medicare for services they had indeed given, then fraud has occurred.

Billing for services to patients who are not homebound are among the most common examples of this type of fraud. Concern about these crimes surfaced when the U.S. Government Accounting Office published a report describing instances where supposed homebound patients traveled regularly, held jobs, and even attended social clubs.

Billing for services not provided is similar to instances where doctors bill for services that did not happen, but different in that these services were supposed to occur in the patient's home. Many of these cases came to light when bills were submitted to Medicaid or Medicare that detailed services that clearly could not have been provided. Some providers have billed for services when they were actually in another state; others have billed for services when they were incarcerated; and others have billed for services they supposedly provided to deceased patients.

Overcharging occurs in the home healthcare field when providers bill Medicaid or Medicare more than they should. Unlike the previous fraud type, in these cases, services are provided, the bill is just higher than it should be. One of the more common varieties of overcharging by home healthcare providers entails situations where providers bill for more time than they actually spent with the patient.

To commit many of these acts, fraudulent home healthcare providers must sometimes commit forgery. Some may forge a patient's name suggesting that services were provided, when they were not. Others may forge a doctor's name, suggesting that the patient was homebound when she was not. Still others may forge documentation suggesting that they are licensed providers when they are not.

Related to forgery is negative charting. Negative charting occurs when home healthcare providers alter medical records to make it appear that patients are sicker than they actually are. Providers do this in order to increase the likelihood that a patient will be seen as homebound by Medicaid or Medicare regulators.

Substitute providers, as a type of home healthcare fraud, describes instances in which an unlicensed aide provided care to patients, but bills Medicare or Medicaid as if a licensed professional provided the care. More often than not, this type of fraud is actually committed by an agency rather than an individual home healthcare provider. The agency, wanting to maintain a certain level of productivity, may allow unqualified home healthcare employees to work for them.

As with prescription fraud and physician fraud, double billing is also found in the home healthcare field. More often in home healthcare, however, are instances where fraudulent providers encourage their vulnerable patients to pay out of their own pockets more than regulations permit. Finally, kick-backs occur when providers work together, referring patients back and forth between one another in order to generate a profit. In home healthcare, kick-backs are especially problematic when doctors or hospital staff receive cash or other property from home healthcare agencies in exchange for referrals.

#### CAUSES OF FRAUD

Three reasons fraud is committed by healthcare professionals include structural explanations, training, and systemic issues. In terms of structural explanations, providers often point to the reimbursement rates of Medicaid and Medicare. Both insurance schemes tend to reimburse doctors far less than they would actually receive from other patients. In effect, they are losing time and money, they say, by taking on patients covered under these programs. To make up for this lost time and money, some over-bill or mis-bill so they are billed fairly in their minds.

Training issues have to do with the fact that medical students often learn negative attitudes about government insurance programs even before they become doctors. The belief is that medical students learn from medical professionals about the horrors of dealing with the Medicaid and Medicare system. Even before dealing with the systems first hand, many learn about the low reimbursement rates, the complex rules, the unfair penalties (in their minds), and the bureaucratic nightmare that often comes along with dealing with government insurance agencies.

Systemic issues have to do with the fact that the justice system is not always equipped well enough

to deal with these sorts of cases. Fraud control units exist in 47 states, but directors note that they are understaffed and under-funded.

Doctors are often able to blame the billing problems on their billing clerks, and they are also able to hire the best attorneys to keep them out of trouble. They are seen as upstanding members of their communities. While it is common to hear of citizens complaining about dangerous neighborhoods, drugs, and other community problems, it is unheard of that one would complain about doctors. Prosecutors are in political positions, and generally respond to the will of the voting public. This lack of outrage further insulates doctors from prosecution.

It is important to note that most providers do not engage in these fraudulent or abusive activities. Indeed, most healthcare professionals abide by their strong ethical codes. The few providers who commit these criminal acts, however, create a great deal of problems for the entire medical profession.

#### SEE ALSO

healthcare fraud; insurance fraud; scams; elite crime; medical malpractice..

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## Merrill Lynch

HISTORICALLY, Merrill Lynch has been one of the most powerful securities firms on Wall Street since it was established in 1907 by Edmund C. Lynch. However, beginning in the 1990s, Merrill Lynch, like so many other securities firms, was caught up in a swirl of civil and criminal charges resulting from corporate greed.

In the 1990s, Merrill served as the financial adviser for the Orange County Fund of California, which announced a \$1.5 billion loss on December 1, 1994, making it the largest municipal failure ever reported in America, and miring Merrill Lynch in the worst scandal of its history. Robert L. Citron, the treasurer of the Orange County Fund, had worked with Merrill employees to purchase high-risk securities with large returns rather than the safer, low-risk securities usually purchased by municipal entities. After Citron resigned, hundreds of lawsuits were filed, including a \$2 billion lawsuit filed by Orange County against Merrill Lynch.

Other participants in the suits against Merrill included individual participants in the Orange County pool, private investors, Orange County taxpayers, bondholders, and five money markets. At issue in the suits was whether Merrill Lynch had acted ethically in selling the risky securities to the Orange County Fund without proper warnings. Merrill Lynch reportedly spent \$3 million a month fighting the suits. The Securities and Exchange Commission (SEC) investigation came to an end in 1999 when Merrill Lynch paid a \$2 million fine.

Merrill's problems were not limited to California. The Inspector General of Massachusetts also opened an investigation into Merrill's municipal bond underwriting activities and sent out subpoenas to the rest of the states and to cities and banks around the country. All told, Merrill's settlements with the SEC, the Commonwealth of Massachusetts, the Attorney General of Massachusetts, and the District of Columbia equaled \$12 million. New York City's controller permanently banned Merrill Lynch from managing bond deals for the city.

A number of Merrill executives were targeted in the course of various investigations. Edward Scherer, who had served as a high-yield analyst for Merrill Lynch, was sentenced to six months in prison and two years on probation on charges of conspiracy, wire fraud, and bribery. Investigators maintained that Scherer had conspired with

Richard Kursman, a bond trader, to purchase bonds for their private accounts at rigged prices, resulting in millions of dollars of illegal profits. Kursman was allowed to plead guilty to the single charge of wire fraud in exchange for testifying against Scherer. In December 1996, Mark Ferber, a former partner in Lazard Freres, who had neglected to report over \$2.6 million in secret payments from Merrill Lynch was sentenced to 33 months in jail and was required to pay a \$1 million fine after being convicted on 31 counts of mail and wire fraud. Additionally, the SEC fined Ferber \$650,000 and banned him from the securities industry for life.

## SCANDALS

Various other Merrill Lynch employees also involved the company in scandals. Linda Bustin, who had been a broker in the Burlington, Massachusetts, office, was fined and sentenced to 18 months in prison and three years probation for embezzling over \$300,000 in forged checks and fraudulent accounts from 12 Merrill Lynch clients. Naham Vaskevitch, the former managing director of Merrill Lynch London, pled guilty to insider trading. He had previously settled a civil suit brought by the SEC for \$2.9 million. Merrill's office in Lugano, Switzerland, negotiated a \$5 million settlement with a French candy merchant who had lost over \$3 million dollars when Merrill employees had, without permission, used his funds in derivative trading. Merrill also settled a lawsuit brought by 3,500 investors who had lost substantial amounts by following Merrill employees' advice to invest in ancient art and rare coins.

George Yu, who had worked in Merrill's Fort Lee, New Jersey, office was charged with attempted murder and sentenced to 10 years in prison after he hired a hit man, who turned out to be an FBI agent, to kill a client. Merrill Lynch also suffered substantial embarrassment when Janie D. Thomas, the so-called "stockbroker to the stars," vanished after making false statements to at least 50 clients, including singer/songwriter Paul Anka. Thomas's actions cost Merrill \$14 million.

In business circles, 2000 became known as the Year of Corporate Scandal. Merrill Lynch's part in the scandal resulted in a reduction of 22,000 to Merrill's payroll, including a number of senior executives. Former Merrill Lynch research analyst Henry Blodgett had a starring role in this scandal

that led to a \$100 million fine for Merrill. Charges arose from a tainted research deal that lost Merrill's clients millions of dollars. Blodgett's activities were well documented through various emails, which revealed that Blodgett and his accomplices had been involved in at least 52 separate transactions in which they had inflated stock ratings of various companies in conjunction with investment bank clients. Blodgett claimed that the deals had earned \$115 million for Merrill Lynch between December 1999 and November 2000. Merrill records revealed that Blodgett's personal income had risen from \$3 million to \$12 million during the relevant period. Although he refused to admit any wrongdoing, Blodgett was required to pay a \$4 million fine for his activities and was banned from the securities industry for life. In October 2001, a corporate e-mail was leaked to the press in which Merrill Lynch "requested" 50,000 employees to attend a seminar teaching them about the perils of using e-mail, which could be subpoenaed by prosecutors and used in court.

On March 17, 2003, civil fraud charges were leveled against Merrill Lynch and three former top executives for the part they played in Enron Corporation's scandalous attempts to inflate its earnings. Merrill Lynch agreed to pay \$80 million in fines for two questionable transactions with Enron. One of the transactions involved a \$7 million deal for a power-generating barge in Nigeria; the other transaction concerned various energy trading deals between the two companies.

While Merrill admitted no wrong in the Enron transactions, the company agreed to an injunction that ensures that the company will refrain from further violations of securities laws. Additionally, Merrill agreed to allow independent auditing of its activities over an 18-month period and was placed under the supervision of an attorney selected by the Department of Justice.

The executives charged in the Enron affair were Daniel Bayly, Merrill's former head of global investment; James A. Brown, Merrill's former head of strategic asset lease and finance group; and Robert S. Furst, the executive in charge of the Merrill/Enron relationship. Pleading not guilty to the charges of conspiracy, obstruction of justice, and perjury, the three Merrill executives were each released on a \$100,000 bail, which included \$50,000 in cash.

If convicted, the three could serve time in prison and would also be required to pay personal

fines. Thomas W. Davis, the former vice chairman for private equity and research, and Schuyler M. Tiney, head of energy investment banking at Merrill's Houston office, were not formally charged, but both were fined for refusing to testify about Merrill's dealings with Enron. Merrill Lynch was also ordered to pay an additional \$100 million to settle global securities disputes.

#### SEE ALSO

insider trading; securities fraud; Securities and Exchange Commission; Enron Corporation.

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INDEPENDENT SCHOLAR

## Metallgesellschaft

A DERIVATIVES trading scheme launched by Metallgesellschaft's U.S. trading subsidiary, MG Corp., resulted in \$1.9 billion in losses for the industrial conglomerate, bringing it to the edge of bankruptcy in early 1994. German banks, including Deutsche Bank, a major investor in Metallgesellschaft, provided a bailout worth more than \$2 billion. MG Corp.'s adventures in futures trading started in 1991 when MG Refining and Marketing hired Arthur Benson, who later sued Metallgesellschaft for wrongful termination after he was held responsible for trading losses. He also claimed the company ignored his plan to recoup losses.

The original trading scheme was not illegal and might have succeeded on a smaller scale. MG Corp. sold long-term contracts to provide petroleum

products to customers at a fixed rate. These contracts appealed to buyers by reducing risks associated with a volatile energy market.

If oil prices fell, MG Corp. would make a profit. If oil prices rose, however, MG Corp. would be committed to sell oil to its customers at a loss. The company therefore developed a hedging strategy that involved buying oil futures contracts on the New York Mercantile Exchange (NYMEX) and arranging private swaps. Derivatives theorist Anatoly Kuprianov explains that MG Corp. was practicing an accepted strategy known as a stack-and-roll hedge. MG Corp. repeatedly bought bundles (stacks) of oil futures, rolling them over at their maturity date to realize a small profit and obtain a new stack. Behind this strategy was the assumption that if oil prices dropped, the value of the derivatives would increase to cover the loss, and vice-versa. Because MG Corp. required so many futures contracts to hedge its long-term commitments—the company reached 55,000 open contracts on NYMEX, well over the ordinary 24,000-contract limit—other traders could predict its actions and bid against it.

MG Corp. had not anticipated plummeting oil prices in fall 1993, cash flow problems from a mismatch in timing between the long-term and short-term contracts, and NYMEX's demand that the company increase its margin to protect the exchange from a potential default. Nobel laureate Merton Miller argues that Metallgesellschaft's problems were the result of management and U.S. regulators failing to understand the strategy and thereby mishandling it.

Similarly, some experts aver that upper management's insistence that MG Corp. liquefy contracts to cover their margins was what turned paper losses into real losses. However, an investigation by the U.S. Commodity Futures Trading Commission (CFTC) determined that MG Corp. had gone on a sales drive in the last three months of 1993, after oil prices started to fall, thus improving year-end results while increasing the company's exposure by about one-third. The CFTC fined Metallgesellschaft \$2.5 million in 1995 and declared many of its short-term contracts void.

Seventeen oil companies later sued MG Refining and Marketing, the U.S. subsidiary of Metallgesellschaft, for violating its long-term contracts to provide them with petroleum. The plaintiffs also claim that Metallgesellschaft lied to the CFTC in

order to have the contracts declared illegal. This suit was still in progress in early 2004.

In November 1993, before the scandal broke, Metallgesellschaft's directors had announced a loss of only \$216 million on oil trading. After the true scope of the losses became apparent, the directors were fired. Both U.S. and German authorities considered criminal charges against the directors for breach of fiduciary duty, and questions were raised about MG Corp.'s contracts to buy petroleum from Castle Energy.

The Castle contracts allowed MG Corp. to pay itself for making a profitable investment. MG Corp. was one of the investors in Castle, a small U.S. oil company. MG Corp. signed off-take contracts to buy all of the output of Castle's two refineries at above-market prices, thus guaranteeing that Castle would remain profitable. When MG Corp. needed to escape from its loss-generating long-term oil contracts in late 1994, part of the deal was that it would cancel \$375 million of Castle's debt. MG Corp. estimated that it lost more than \$630 million on its relationship with Castle.

An independent auditor's report assigned the blame for Metallgesellschaft's near-bankruptcy on dismissed chairman Heinz Schimmelbusch and former finance director Meinhard Forster. Metallgesellschaft sued Schimmelbusch, who countersued for defamation. At last report, in 1996, settlement talks had fallen apart over Schimmelbusch's unwillingness to admit fault. No criminal charges against Schimmelbusch or other directors were pursued.

By 2000, a leaner, more focused Metallgesellschaft, divested of its trading activities, had returned to profitability and was on the verge of regaining its position among Germany's top 30 blue-chip stocks.

#### SEE ALSO

Germany; securities fraud; Securities and Exchange Commission; insider trading; fiduciary fraud.

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## Mexico

THE COLLUSION between white-collar crime and organized crime in Mexico has been rampant. For much of the 20th century, the Mexican government controlled organized crime. After the Mexican Revolution of the 1910s, the Mexican elite formed an official political party that eventually became known as the PRI. The PRI had a monopoly over political power and used this power to manipulate and exploit organized crime. Authorities sought out successful organized criminal groups, such as drug traffickers, and forced them to do the government's bidding. The government provided immunity from prosecution in exchange for payments used for government programs, political campaigns, and personal enrichment. Authorities expected criminals to cooperate. Failure to do so could result in prosecution or even being killed.

Due the fact that many Mexican government institutions such as the police or the attorney general's office, traditionally had little or no budget, they had to seek out their own operating funds. In order to do so, authorities would arrest crime figures, confiscate their goods, and then submit the goods to the Ministry of the Treasury in exchange for a payment. Furthermore, local officials often forced criminals to turn over valuable possessions such as homes and automobiles.

At other times, criminals would give suitcases filled with money and other gifts to their own attorneys, who would then turn them over to low-ranking government officials, who in turn submitted the payments to senior officials. Some of this money made it as high as the presidential palace, where it went into a slush fund. A good example of the gov-

ernment-organized crime connection is the 1997 arrest of General Jesús Gutiérrez Rebello, head of the National Institute to Combat Drugs (INCD). Gutiérrez was charged with protecting Amado Carrillo Fuentes, a major drug cartel leader, in exchange for gifts that included luxury apartments, vehicles, jewelry, and money. At the same time he provided protection for Carrillo Fuentes, Gutiérrez also cracked down on a rival drug cartel.

Exposing the connection between authorities and criminals could be dangerous. In 1984, journalist Manuel Buendía was killed after allegedly acquiring a video of a meeting between high-ranking government officials and drug dealers. In 1985, drug traffickers kidnapped, tortured and killed U.S. Drug Enforcement Agency agent Enrique Camarena Salazar. It was rumored that José Antonio Zorrilla, director of the security service Dirección Federal de Seguridad (DFS) protected the drug traffickers. Later, the brother-in-law of President Luis Echeverría was convicted by a federal court in Los Angeles, California, for his involvement. Eventually, the DFS was dissolved amid corruption charges, as Zorrilla was also convicted in the Buendía assassination.

## AUTOCRACY TO DEMOCRACY

In the 1980s and 1990s, however, this system began to change. As the PRI lost its stranglehold on political power and Mexicans began to demand a more democratic government, authorities held less control over organized crime. A more pluralistic society has given criminals more autonomy from government domination. Such freedom has led to greater organized criminal activity that has become more aggressive and violent, an occurrence that often accompanies the transition from autocratic political systems to more democratic ones, as has been the case in Russia.

Perhaps the most significant example of the increased audacity and violence of organized criminals was the March 1994 assassination of presidential candidate Luis Donaldo Colosio. President Carlos Salinas had designated Colosio as his successor, as was the practice of Mexican leaders. Many believe that Salinas's political opponents along with Mexican drug lords ordered Colosio's murder in the belief that they would benefit from eliminating him. Many traditional politicians in the PRI were unhappy with the dramatic changes Sali-





*The hotel zone in Cancun, Mexico, shares the country's legacy of major ties between the government, organized crime, and the financial community, even as Mexican authorities seek to limit the rise of corruption.*

nas had implemented and worried that Colosio would continue the trend. Drug leaders, particularly the Gulf Cartel, worried that Colosio would crack down on their operations. The leaders of this cartel were especially upset when Colosio refused a meeting with them. He was assassinated two days after refusing this request.

## DRUG TRAFFICKING

International syndicates and local organizations are involved in the production, transportation, and distribution of illegal drugs in Mexico. As a consequence, there has been an increase in violence and corruption in the country. The drug trade is not new to Mexico; since the early 1900s, Mexico supplied the United States with marijuana and heroin. A significant change took place in the 1980s when Colombian drug traffickers began sending cocaine to the United States through Mexico. By the 1990s, more than half of the cocaine entering the United States passed through Mexico and Mexican drug traffickers earned billions of dollars. By the late-1990s, Mexican traffickers even were bypassing the Colombian operators, setting up their own wholesale and retail operations in the United States, and making connections directly with producers in Peru and Bolivia. Thus, Mexican drug cartels had become sophisticated organized crime operations.

These developments had a significant influence on politics and corruption. Among the most notable examples of the link between drugs, politics,

and crime was the 1994 murder of José Francisco Ruiz Massieu, secretary-general of the PRI, Mexico's leading political party. The victim's brother, Mario Ruiz Massieu, then the assistant attorney general was in charge of the investigation. He claimed that Mexican drug bosses had ordered the murder and that high-ranking politicians were also involved in the plot. He later argued that the PRI attempted to cover up the details of the assassination. Then in February 1995, Raúl Salinas, brother of President Salinas, was arrested in connection with the murder. Salinas was found guilty in 1999 and rumors circulated that former president must have known of the murder plot.

Money laundering has also become widespread in Mexico, largely a result of the narcotics trade. Drug money earned in the United States by both Mexican and Colombian cartels is often laundered through Mexico's foreign exchange market, especially on the black market. There are several forms of getting dollars from the United States to Mexico. Sometimes, cartel operatives simply physically carry the money across the border to be deposited in Mexican banks, which are often less vigilant than U.S. banks. Other times, they convert cash into checks or money orders in the United States, then ship them to Mexico.

Another option is to deposit the money in a U.S. bank and then wire transfer the funds to a Mexican bank. While some of the drug money stays in Mexico to meet expenses, much of it is subsequently sent out of the country for further laun-

dering in places such as London, Panama, or the Cayman Islands. While it is impossible to know exactly how much drug money flows into Mexico to be laundered, it is estimated at over \$2 billion.

## BANK FRAUD

White-collar crime was rampant in the Mexican banking industry during the 1990s. Illustrative of this trend was a bank insurance fraud scandal that came to light in 1998 due to a campaign by the PRD political party to expose corrupt banking and political practices. In 1990, the Mexican government created the Banking Fund to Protect Savings (Fobaproa) in order to insure bank deposits. Salinas hoped to build confidence in a banking system that he had privatized. In this environment, banks made many large loans to wealthy Mexicans. When the Mexican peso collapsed in December 1994, many borrowers were unable to pay their debts. The government of Ernesto Zedillo poured money into Fobaproa in order to rescue the banking system.

The fund took over the debts of some of the country's richest citizens, many of whom happened to be prominent contributors to the PRI. This process essentially transformed the private debts of rich Mexicans into public debt, which had reached \$55 billion by 1998. Many critics claim that corrupt bankers simply made loans to themselves that they never intended to pay back. They further complain that Zedillo bailed them out because they were important campaign contributors.

Among the most notorious bankers was Carlos Cabal Peniche, a wealthy businessman involved in both the food distribution industry and banking. He was also involved in drug dealing and money laundering. Cabal Peniche set up dummy corporations to which his banks lent money. He used the funds to acquire legitimate corporations and to make campaign contributions to the PRI. When the dummy corporations collapsed, Fobaproa absorbed the debts Cabal eventually fled the country with funds estimated at least \$700 million and as much as \$2 billion. He was eventually caught in Australia.

## SEE ALSO

drug trafficking; bank fraud. United States; Central America; money laundering.

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## Microsoft

SINCE THE 1990S, Microsoft (MS) has been targeted for investigation by the U.S. Department of Justice (DOJ), the European Commission, the Japanese government, and several software trade associations. Microsoft has also been sued by individuals, other companies, and a number of states. There are two schools of thought on Microsoft's legal problems. One school argues that the government and MS competitors are out to get Bill Gates and his company because Microsoft has been so successful. The other school of thought insists that Gates and Microsoft have consistently engaged in cutthroat competition designed to shut out all competition through any means available.

Specifically, Microsoft has been charged with violating the Sherman Antitrust Act by forcing computer vendors and manufacturers to load new computers with Microsoft Windows as an operating system. Secondly, the company has been charged with forcing out browser competition by requiring vendors and manufacturers to include Microsoft Internet Explorer (IE) as the browser of choice for Windows and by removing icons for other browsers, such as Netscape, from computer desktops. Consumer advocate Ralph Nader called Microsoft "the most dangerous company in America today."

There is little doubt that Microsoft has dominated the computer software industry since its introduction of Windows 95 operating system in August 1995. Microsoft had been working for years

to provide an operating system for the PC that would be as user friendly as that of Apple Macintosh computers. In 1988, in a landmark case, MS convinced the courts to uphold its right to copy the Graphical User Interface (GUI) used in Apple computers. Microsoft then introduced Windows 3.0, a weak and bug-filled imitation of the Mac. While its operating system was being fine-tuned, MS worked on innovations for its basic Windows programs, which would extend the market for Microsoft products.

As far back as the mid-1970s, MS had begun developing a string of improvements in the way that computers operate. In 1975, MS introduced the first Basic programming language for the personal computer (PC). The next year, Microsoft Word 1.0 became the first PC-based word processor to support a mouse. Within the next two years, Word 3.0 became the first PC-based word processor to support a laser printer. In 1987, MS introduced Excel, the first spreadsheet for Windows and followed it up two years later by adding the capability of generating tables to MS Word. In 1989, MS Office introduced the first suite of business applications. In 1991, MS incorporated multimedia into MS Works and drag-and-drop was added to MS Word.

In 1994, MS and Timex united to provide the first wristwatch to accept data from a computer. The following year, MS combined Intel's hardware with its own software, and Windows 95 was introduced. The rest, as they say, is history. From that point on, Microsoft became the force to be reckoned with in the computer industry. Within the first few months, Windows 95 sold over 50 million copies. Further improvements were made in Windows 98, Windows NT, Windows 2000, and Windows XP.

As Microsoft expanded and cornered a greater share of software markets, MS marketing practices were challenged by Netscape, Sun Microsystems, Novell, Lotus, and Word Perfect. In 1998, Robert Bork, a nationally known antitrust scholar who was notorious for his part in Richard Nixon's "Saturday Night Massacre" and for unsuccessfully seeking a seat on the Supreme Court in 1987, joined Netscape, MS's closest competitor for the browser market, as a consultant.

Bork and Robert Dole, who unsuccessfully challenged Bill Clinton for the presidency in 1996, joined forces to lobby for charges against Microsoft. Senator Orrin Hatch later joined them in

their attack on MS. There was a certain amount of irony in seeing three staunch conservatives line up against big business with liberal Ralph Nader, arguing for restrictions on free trade.

## WORLDWIDE DOMINATION

Microsoft's competitors argue that as far back as 1996, Gates and company developed their strategy for worldwide domination of personal computers. They argue that MS made plans to totally annihilate the Mac, IBM's OS/2 and UNIX operating systems, and the Netscape browser. Reportedly, by 1997, MS had a cash reserve of over \$10 billion, allowing them to buy competitors who threatened them. Microsoft bought a dozen companies in 1997 alone by adopting an "absorb-and-extend" strategy in which MS copied the competitor's product, modified or extended it with MS-generated improvements, then re-offered it to consumers.

In 1980, Microsoft had licensed MS-DOS to IBM to be pre-installed on all new computers. Ten years later, Microsoft and IBM announced at an industry trade show that they would work together on developing future operating systems. Afterward, the Federal Trade Commission (FTC) decided to investigate IBM, the connection with Microsoft became evident. When FTC attention turned to MS, government investigators discovered that Microsoft's licensing agreements had required that computer manufacturers who sold computers loaded with MS-DOS 6.0 and Windows 3.1 pay MS royalties on all computers sold whether or not that particular computer contained MS software. MS licenses also mandated a minimum commitment and discouraged manufacturers from including non-Microsoft software on their computers.

The FTC decided not to pursue charges against MS. However, in 1993, the Department of Justice opened its own investigation into Microsoft. In 1994, Microsoft and DOJ negotiated a consent decree under which Microsoft agreed to change its licensing practices, but a district court judge overturned the decree the following year. The DOJ investigation of MS expanded at the same time that an appeals court restored the consent decree. Microsoft then accused DOJ of "harassment and abuse" in their investigation. In response, DOJ, egged on by Netscape, extended its investigation even further. In 1997, Attorney General Janet Reno fined MS \$1 million per day until the company

complied with the 1995 consent decree and charged MS with contempt.

In May 1998, in *U.S. v. Microsoft Corporation*, a federal district court was asked to determine whether or not Microsoft engaged in monopolistic practices with its Windows operating system and with Internet Explorer. The federal case combined 20 other suits against Microsoft with the case brought by the DOJ. In the initial decision, the judge found Microsoft guilty of antitrust violations and ordered Microsoft to divide its operating system and other software into two separate companies. Gates argued that Microsoft should be allowed to compete in a free market with no controls: "Unless we're allowed to enhance Windows, I don't know how to do my job."

Microsoft appealed the district court's decision, arguing that the company was innocent of all antitrust accusations, that there were problems with procedural and factual factors in the government's case, and that the judge acted unethically by making public remarks about the merits of the case while it was still pending. MS also asked that the judge's ruling be set aside due to partiality. The appeals court reversed the district court's finding that Microsoft had engaged in monopolistic practices, and remanded the case to a lower court.

In March 2004, a European Union (EU) court ruled in an EU antitrust case against Microsoft, stating that the company must offer two versions of its Windows program. The company promptly filed an appeal.

#### SEE ALSO

Sherman Antitrust Act; antitrust; Justice, Department of; illegal competition;

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## Middle East

THE MIDDLE EAST CONTAINS a wide variety of nations and states that is as diverse in economic opportunities as it is in ethnicity, religion, and language. It ranges from Iran and Iraq bordering on the Afghanistan region in the east, the Persian Gulf states in the south, Israel, Palestine, Jordan and Syria on the coast of the Mediterranean Sea, Egypt and the north African Muslim states to the west. The cultural and economic patterns linking this region also link it in some contexts with Turkey and the island of Cyprus. It is, therefore, a complex region with a great deal of diversity.

It would be simplistic to classify it as the Muslim region of the world because that would be to ignore the many important ethnic and religious minority peoples contained within its scope, and also the other Muslim peoples in other parts of the world. Nevertheless, the majority of the region has been welded together historically through context, most notably the Ottoman Empire that was finally dismembered after centuries of rule at the end of World War I. The legacy of the bureaucracy of the Byzantine Empire and its inability to provide economic growth partly led to the institutionalized corruption that became endemic within its borders, symbolized by the Egyptian word and concept of *baksheesh*.

Political and religious divisions have led to widespread and longstanding violence in many areas and this has led to many business activities being kept secret. For reasons of cultural practice and habit, many agreements are made on the basis of mutual friendship or kinship and are not subject to wider scrutiny. This practice is seen both in government and private sectors. The results of this include a wide range of opportunities for corruption and bad practices to flourish.

#### OIL CORRUPTION

Corruption is believed to be particularly widespread in the oil and construction industries, both of which are of considerable importance in the Middle East as oil wealth from reserves discovered in the 20th century led both to a demand by external powers to control the oil through either military force or commercial domination, as well as a burst of infrastructure building and more general expenditure by the newly rich owners.

The discovery of oil in some Middle East nations has led to a widening of the gap in economic opportunities between rich and poor, and the importance of the industry has meant that political considerations have underscored some commercial decisions. The importance placed upon defense and security in many states has also inspired a thriving armaments import trade that has necessitated additional secrecy on many occasions. In these conditions, in which few decisions and the reasons for making them are made public, in which most countries are undemocratic and in which a free press has struggled to establish itself, it is not surprising that there have been many opportunities for corruption and other forms of white-collar crime.

These include gun running and smuggling, prostitution and human trafficking, money laundering, support for and sponsorship of terrorism, fraud and embezzlement, and other activities. The division of labor according to ethnicity in many countries has meant that some groups are discriminated against and this has taken the form of lower wages and less desirable working conditions. In recent years, for example, Palestinians wishing to work in Israel have been subject to various regulations and difficulties, which have arisen as a result of the violence of the Intifada (uprising).

## ARMED CONFLICT AND CORRUPTION

Indeed, the whole of the Middle East must, in many ways, be seen against the backdrop of the Israeli-Arab struggle, for this has been instrumental in shaping many of the political regimes in the region and that, in turn, has a significant impact upon the business environment. The Jewish state of Israel was established in the years following World War II through, at length, the assistance of Western powers, and in the teeth of resistance by the Arab peoples, especially the Palestinians who were forcibly displaced as a result.

Intensive but largely inconclusive debate concerning historical ownership and precedent of the land and its resources has been punctuated by a series of violent wars, each won by Israeli forces armed with superior technology and organization. Arms and other support have been supplied to Israel by the United States and also other players in the arms trade. The British arms trade with Israel continues to rise to significant numbers and reached £22 million (approximately \$35.2 million)

in 2001. However, this continues to be dwarfed by American dealings with Israel. Weapons sales, like overseas development assistance, are only occasionally linked to human rights issues, which are frequently ignored or brought back to prominence for short-term political reasons.

Palestinians and their supporters, including many terrorist groups, have been secretly and not so secretly supported by states such as Syria, Iran, and Iraq, partly through proxy organizations such as Hamas and Hizbullah. Coming under attack by rockets and mortars from southern Lebanon, the Israeli army invaded and occupied the area for years, which contributed to the intensification of civil war in Lebanon.

The crisis in Lebanon led to the exodus of a large number of companies, many of which had been conducting business successfully in the multicultural, sophisticated environs of Beirut (Lebanese capital) for years. Those firms, notably banks and financial institutions, sought an alternative base in the Middle East and found it in oil-rich Gulf states seeking to diversify sources of income.

The conflict between Israel and the Arab nations has featured military force and terrorist attacks, together with the widespread expropriation of Palestinian property by Israeli authorities and the denial of some fundamental labor rights for Palestinian and Arab labor in Israel. It has also led to high levels of smuggling, particularly in weapons but also in other merchandise to pay for weapons and other expertise. In the breakdown of civil order inevitable in such situations, there have been numerous opportunities for petty corruption, bribery, and extortion.

The armed struggle has also seen the blurring of the line between state and individual action. The first Arab-Israeli cyberwar was staged in 2000, when a group of Israeli hackers crippled the Hizbullah website. The next such war may possibly erupt at any time and may take a number of forms more dangerous than defacing existing materials. These actions are a form of economic warfare by individuals and private groups and, therefore, properly classified as white-collar crime.

The internet offers additional opportunities for criminal organizations, as reports of attempts to arrange illegal gambling rings and also to fix international cricket matches in the United Arab Emirates state of Sharjah by individuals linked to the Indian underworld attest.

## IRREDENTISM

The Arab-Israeli conflict is not the only example of armed struggle within the region. In the 1980s, a particularly bloody war erupted between Iraq and Iran and, subsequently, Iraq invaded its oil-rich southern neighbor of Kuwait. In addition to the desire to control resources and enforce religious and political supremacy, armed conflicts have also been motivated by irredentism, the wish to redraw political boundaries so that they match historical cultural patterns. The current political boundaries were mainly drawn by the Western powers upon the collapse of the Ottoman Empire and in the wake of world war. Consequently, there are numerous examples of a mismatch between nations as represented on the map and nations as many people believe they should be. This leads both to cross-border personal and commercial networks that are adept at eluding official inspections, and also the widespread desire to circumvent the authorities who are not fully considered to be acting with appropriate jurisdiction.

The Iraq invasion of Kuwait and the subsequent Persian Gulf War in 1991 led to Iraqi withdrawal but the continuance of the ruling regime under Saddam Hussein. This regime was known to have committed numerous atrocities against its own people and the international community decided the best way of preventing it from committing further acts of aggression was to impose sanctions on the import of any materials that might be used to manufacture further weapons, together with a program of inspections by United Nations officials searching for existing weapons or programs that might lead to biological, chemical, or nuclear weapons capabilities. Sanctions proved very difficult to police, as the borders of Iraq are very lengthy and difficult to patrol and, as mentioned above, many local networks exist quite capable of avoiding officials.

There was also considerable incentive for firms to break the sanctions, as the Iraqi government was willing to pay high fees for importing banned equipment. In the United Kingdom, as one example, the Churchill Matrix firm was accused of exporting to Iraq material that may have been used to create a "super gun" (basically, a huge cannon capable of shooting missiles capable of reaching Israel). The trial of the directors of the company collapsed when it was revealed they were acting with the connivance of the British government, and had even

been involved in spying for them. Legend has it the inventor of the super gun, and the man who sold the concept to Iraq, Canadian inventor Gerald Bull was eliminated by Israel's intelligence service, Mossad.

Sanctions imposed against Iran and Libya for what was considered to be their roles in sponsoring terrorism also inspired many cases of smuggling and secret dealings. In these cases, there was much less international unanimity that sanctions would be an appropriate tool; some Western European states had considerable interests in those countries and were unwilling to abandon them.

## ILLICIT DRUGS

The Middle East has long faced the problem of illegal drugs—mainly the opium and heroin created from the poppy. It is estimated that there are approximately 2 million drug addicts in Iran, for example. Much of the supply of such drugs derives from the wilder regions of Afghanistan, where it has historically proved difficult for central authorities to control activities. This is no better demonstrated than by the establishment of al-Qaeda terrorist training camps in the remote and desolate land.

In the 1980s, drug production was accelerated in Afghanistan to get cash to fund resistance to the Soviet Union invasion of the 1980s, although it had existed at some level for hundreds of years. Following the U.S.-led war against al-Qaeda and its sponsor, the Taliban, in Afghanistan in 2002, a hiatus in drug production was followed by greatly enhanced production levels that threaten stability in the region. Distribution networks through central Asia and through Iran and Iraq are frequently unpoliced as a result of lack of resources, and the effects of warfare, corruption, and bribery. This has led to rapid distribution of drugs and associated problems of HIV infection through shared needles, and organized crime gangs seeking control of trade routes.

## MONEY LAUNDERING

The al-Qaeda terrorist network is only the most visible example of terrorist gangs in the region. Most groups receive money from supporters, often in other countries, which is then used to buy weapons and other materiel. The degree of legality or illegality in these transactions is contested, since terrorists



*Cairo, Egypt, represents the modern, urban side of the Middle East. Yet, ancient criminal customs prevail.*



*The city of Sana'a in Yemen suggests the labyrinths of crime inherited from the Byzantine Empire.*

appear to be freedom fighters or justified warriors to at least their supporters. Nevertheless, it is clear that a great deal of weapons smuggling does take place and the weapons are paid for using money for which proper accounting procedures have not been followed. International charities, or non-governmental organizations (NGOs) have been accused of being part of this system, especially Islamic charities that are supported by those professing a conservative social order and radical foreign policies. This is in addition to the regular defense trade in the region, much of which itself is subject to suspicion of corruption and other forms of illegality.

## LABOR LAWS

Labor laws are little respected in many Middle Eastern countries and scrutiny of their observation is hampered by the banning of trades (labor) unions, and the absence of international monitoring organizations such as the International Labor Organization (ILO). Middle Eastern nations, among others, have generally been unwilling to make concessions to the ILO or to acknowledge workers' rights.

Refusal to entertain international labor standards is, in part, a political and religious issue as it is believed that such standards pay insufficient attention to Muslim practices that restrict the ability of women to participate in the labor force in many countries. However, more important is the traditional and tribal mentality of governance in many

states. This means that a small elite, generally connected by family ties to the ruler, controls all important posts either directly, through appointment or through the unwillingness of anyone to be disobedient for fear of punishment.

This ruling style is seen very clearly in the six Gulf states of the Gulf Co-operation Council (the Kingdom of Saudi Arabia, the United Arab Emirates, Bahrain, Qatar, Oman, and Kuwait), as well as in Yemen. States which have nominally undergone political revolution to replace tribal rule have, in some cases, instead substituted dynastic one-party politics (for example, Syria and Libya) or have political systems mired in the controversies of vote-buying or voter intimidation (for example, Algeria and to some extent Egypt). Generally, the ruling elite is supported by the teachings of clerics who generally preach in favor of a conservative social order that translates into support for the status quo. Consequently, change delivered by democratic means is generally slow to arrive and when, for example, several women were allowed to stand for office in some local elections in Bahrain, the conservative tendencies of voters ensured that not one was elected.

For the labor market, this tends to mean few safeguards against extortion or means of workplace protection. The large pools of migrant labor in most countries, especially those funded by oil wealth, find themselves particularly vulnerable to exploitation. There are reports of some laborers remaining unpaid for months at a time when there is a

prospect of political upheaval leading to their rapid repatriation. Few avenues of appeal or protest are available and anyone considered to be a troublemaker may be swiftly deported. In some cases, migrant workers are cheated by the job brokers who facilitate their journey overseas, and then are cheated by their employers when they arrive.

Inevitably, women are particularly vulnerable to this form of treatment. Many women are destined for domestic service or for service industries in which they have very little opportunity to make complaints about inappropriate or unfair treatment. Local women are in many cases prevented from entering the workforce at all or, if they are permitted entry, restricted to a limited number of positions and occupations that are deemed socially appropriate. In some countries, such as the UAE, local people's wages are subsidized, as are many

other aspects of their lifestyle and, throughout the region, nepotism is the accepted and unavoidable norm. In many cases, the real administrative and managerial work is conducted by shadow managers who receive a fraction of the compensation provided to the ostensible executives, and who have very few opportunities to influence policies or important decisions, most of which are made behind closed doors.

An additional implication of this situation of autocratic rule is that few people genuinely believe that reform is either possible or really to be attempted. Throughout most parts of the region, the media have been hampered in any investigative activities because of widespread suppression of dissident voices, corporate ownership of many large media outlets, and a continued sense of deference toward the ruling elites.

Consequently, policy and commercial decisions are not routinely scrutinized in any detail and scandals and incidents that are well-known in the public sphere go unreported. One example of this censorship is the very large incidence of fraud at Dubai Islamic Bank; the story was effectively placed under embargo by the UAE government. Vulnerable workers at the lower levels of the labor market can expect no such protection.

However, there is evidence that this double standard is changing. A new form of investigative media is emerging, sparked by the communication and organization facilitated by the internet and symbolized by the intrusive and challenging presence of the Al Jazeera television network so prominent during the 2003 Iraq War.

The fertility of the region, in combination with historically low life expectancies, has meant that large proportions of people are in young age categories, and more likely to be in favor of change, democracy, and the welcome impacts of globalization. When these voices become more prominent in decision-making processes, it is likely that many of the current practices will necessarily be reformed. Already some landmark cases of corruption have been reported, for example the jailing of the former chief spy of Jordan.

However, the recent United Nations Universal Declaration on Human Rights outlawed discrimination of individuals on grounds of sexual preference, among other rights, and this has been found unacceptable by many of the Middle Eastern nations, which has further removed them from international



*The Mosque of Abu El Abbas near Alexandria, Egypt, is one symbol of the moral force of Islam in the region.*



negotiations and therefore lessened accountability for other actions.

#### SEE ALSO

gender discrimination; drug trafficking; oligopoly; Israel; labor crimes.

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## military-industrial complex

FIRST COINED by outgoing President Dwight D. Eisenhower in his farewell address to the nation, the military-industrial complex is a tight-knit group of interchangeable parts and people, for example, retired military officers moving into defense companies, defense company leaders moving into government. Eisenhower warned the country to be wary of the military-industrial complex. Indeed, the opportunity for fraud and white-collar crime, may not be matched by another segment of society. The collusion between the military and industry has grown significantly since Eisenhower's 1950s.

Before World War II, between 1922 and 1939, annual military budgets averaged 1 percent of the Gross National Product, only \$744 million. Purchasing was by public advertisement for fixed quantities. Bids were sealed, and awards went to low bidders. Government business was not lucrative, and companies solicited it reluctantly.

World War II changed that. Between 1940 and late 1941, the War Department spent \$36 billion, more than the army and navy combined in World War I. And the contracts were cost-plus (allowing for profit), granted to large firms. The top 10 contractors got 30 percent, with General Motors alone getting 8 percent. The top 10 research and development (R&D) contractors received almost 40 percent of the funds. Government invested \$17 billion in industrial plants after the war. Government largesse and protection proved irresistible, and the military-industrial complex was born. Over the next half century, the military-industrial complex cost over \$10 trillion in 2002 dollars.

#### COLLUSION

The relationship was intimate as industry leaders moved back and forth between government and corporations. They met young military officers who, on retiring, used their connections to move by the thousands into the industries they had worked with at the Pentagon.

Government valued the contractors, bailing out Lockheed, Litton, General Dynamics, Chrysler, Grumman, and others instead of holding them to their contractual obligations. Department of Defense (DOD) money subsidized loans, facilities, and R&D. Congress recognized the value of military spending in the home district.

The proposed \$21-billion Boeing tanker lease deal of 2003 was typical. The air force initially did not want the planes. Boeing used insiders in the air force to develop specifications that excluded Boeing's rivals. Perhaps an insider provided proprietary information; possibly the air force used Boeing's documents and arguments to lobby for the tankers once it accepted their value.

The working together of Boeing and air force insiders typified the method by which the military-industrial complex bought planes and ships and most other DOD needs. The military-industrial complex also buys electronic voting devices. In this case, a maker of electronic voting machines reput-

edly containing defects, that make vote fraud easy and undetectable, has a management team replete with retired military and intelligence personnel. On the VoteHere board is ex-CIA director Robert Gates, for example. VoteHere also interlocks with the Carlyle Group and Halliburton. Conspiracists see the connection as rife with potential for fraud and stolen elections.

The aftermath of the Iraq War in 2003 epitomized the military-industrial complex at its worst. The Center for Public Integrity documented that 30 members of the Defense Policy Board (non-elected formulators of defense policy in the Pentagon) had ties to companies that received over \$76 billion in defense contracts in 2001 and 2002 alone. Bechtel made hundreds of millions dealing with the Iraqi regime then got hundreds of millions in non-competitive and open-ended rebuilding contracts. Halliburton, another top contractor reaping millions from the Iraq War, once employed Vice-President Dick Cheney. The spoils of war could top \$100 billion.

Some experts assume that the expansion of NATO (North Atlantic Treaty Organization) is but another opportunity to enrich the ever-shrinking number of defense contractors, because the new NATO forces will have to acquire equipment compatible with that of the United States, that is, the arms made in the United States by the handful of defense contractors.

## THE CARLYLE GROUP

Conspiracists really get exercised over the Carlyle Group, which buys struggling companies (defense, telecommunications, and aerospace), turns them around, and sells them for large profits. Carlyle, the 11th-largest defense contractor with assets of \$12 billion, is reportedly the gate-keeper between private business and defense spending. Carlyle members include former U.S. president, George H.W. Bush, former British prime minister John Major, and former Philippine president Fidel Ramos.

Carlyle also has ties to the Saudi Arabian royal family, including members of Osama bin Laden's family. Moreover, Carlyle tied itself to George W. Bush by placing him on the board of one of its companies, Caterair International, in 1991. Critics decry Carlyle as the exemplar of crony capitalism and a potential subverter of the democratic process because it is the strongest in the iron triangle, with

no significant competitors. And it's secretive. In the latest manifestation of the military-industrial complex, defense contractor DynCorp hired mercenaries, private military companies, stocked with military veterans, who provide contract services ranging from logistics to, sometimes, actual combat capabilities. DynCorp began in the 1950s as an air force contractor, and evolved as part of the military-industrial complex into a prime contractor for the Central Intelligence Agency (CIA) and DOD. By subcontracting, the DOD can disclaim responsibility.

## CONSPIRACY

To conspiracists, the military-industrial complex engages in more than business collusion. Thierry Meyssan argues in *l'Effroyable Imposture (The Horrifying Fraud)* that the September 11, 2001 terrorist attacks were the work of the military-industrial complex. Or, they can track the post-9/11 anthrax scare to weapons-grade anthrax linked circuitously to the CIA and DOD. They can link the military-industrial complex to the assassination of John F. Kennedy, arguing that the complex feared Kennedy would spoil its profits by withdrawing from Vietnam. The ultimate conspiracists see the military-industrial complex as preparing a coup, a switch from behind-the-scenes control to outright takeover of the United States.

## SEE ALSO

government procurement fraud; government contract fraud; Eisenhower, Dwight D.; conspiracy.

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## Milken, Michael (1946–)

DURING THE 1970s, Michael Milken developed a financial scheme that made him one of the richest and most powerful men in the United States. He found that he could make enormous profits from rescuing "fallen angels" by engineering financial deals that offered high yields on low-priced debt notes. These so-called junk bonds were financed by Milken and his company, Drexel Burnham Lambert, for small, high-risk companies that had faced financial troubles or even bankruptcy but who still showed potential for recovery. Because of the risks involved, these companies had been generally ignored by investment bankers.

Milken was a master at convincing perspective investors that junk bonds were more lucrative than the more stable low-risk bonds. By the late 1980s, Milken who had become known as the "junk bond king" or simply "the king," seemed to be at the top of the world. However, Drexel appeared more profitable on paper than it actually was because of innovative accounting practices. Before the decade was over, however, both Milken and Drexel were brought down by an insider trading scandal.

In May 1986, Milkin received a subpoena from the office of Rudy Giuliani, U.S. attorney for the Southern District of New York. As Giuliani's investigation unfolded, along with an ongoing investigation by the Securities and Exchange Commission (SEC), numerous charges surfaced. In March 1989, both Milken and his brother Lowell were charged with 98 counts of racketeering and securities fraud. Milken hired one of the most impressive legal/public relations teams ever put together to help him fight the charges. Since he was afraid that he might be vulnerable before a jury composed of minorities, Milken's public relations experts worked hard to improve his image with minorities. Reportedly, Drexel, who footed the bill for the enormous fees

for the attorneys and the public relations team, put Milken on a monthly budget of only \$1.2 million. When ordered to appear before Congress, Milken followed his lawyer's advice and claimed the Fifth Amendment, which protected him from having to say anything that might incriminate him. He was wise enough to know, however, that pleading the Fifth did not solve his problems.

In April 1990, Milken pleaded guilty to six felonies and was forced to pay a \$600 million fine. Drexel Burnham Lambert declared bankruptcy, and the junk bond market collapsed, although it slowly recovered over the course of the next decade. Overall, Milken paid \$1.1 billion to settle the hundreds of lawsuits filed against him and Drexel Burnham Lambert by government agencies, corporations, service providers, and investors.

When the judge read out the verdict that sentenced Milken to two years on each of five counts to be served consecutively, Milken was apparently so stunned that he failed to realize the significance of the term. He later collapsed when he understood that he was actually sentenced to 10 years in prison for violations of securities laws. While Milken could have been sentenced to 28 years in prison, few people thought he would receive a sentence of more than a couple of years. A two- or three-year sentence was typical for white-collar criminals convicted of securities violations.

On March 3, 1991, Milken entered a minimum-security work camp in Pleasanton, California, where he worked 37 hours a week in maintenance and construction. According to his sentence, Milken was not eligible for parole for two years, although the judge had recommended that Milken serve 36 to 40 months before being paroled. In fact, in 1993, Judge Kimba Wood reduced Milken's sentence to the time already served. Many people felt that Milken had been sandbagged by both state and federal prosecutors and wondered why Milken had not been pardoned along with others criminals in the final days of the Clinton administration.

Milken was banned from the securities industry for life. Despite the ban, he later engineered a securities deal that involved Rupert Murdoch's News Corporation (NCI) and Ron Perelman's New World Entertainment. Milken was forced to pay back the \$42 million that he received for the deal, plus another \$5 million dollars in interest. Even while he was imprisoned, Milken received profits from the book, *Portraits of the American Dream*, which Lor-

rairie Spurge, a former Drexel Burnham secretary, published with Milken's support. The book chronicled the successes of the companies that Drexel Burnham Lambert had financed.

After being released from prison, Milken, who was reportedly worth \$500 million at this point, accepted a job as a legal researcher for his lawyer at a salary of \$1,300 a week. Milken was diagnosed with terminal prostate cancer and told that he had no more than 18 months to live. He responded by taking charge of his illness, becoming a vegetarian and taking up yoga. In September 1998, Milken published *The Taste for Living Cookbook: Michael Milken's Favorite Recipes for Fighting Cancer*. His cancer went into remission, and Milken reinvented himself.

He gave away \$250 million to charities and raised \$120 million for cancer research through his charity CaPCURE. With his brother Lowell and Larry Ellison, the head of Oracle software, Milken established Knowledge Universe, which was billed as a "cradle-to-the-grave" educational service. The company provides worldwide educational training.

#### SEE ALSO

Drexel, Burnham, Lambert; insider trading; securities fraud; Giuliani, Rudolph; accounting fraud; Boesky, Ivan.

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## Misappropriation Theory

THE MISAPPROPRIATION Theory is associated with insider-trading law. It is not in the statutes, but has evolved through case law since 1981. Until federal securities laws were enacted in the 1930s, it was generally not a crime for officers, directors, or controlling shareholders to trade stock in their own

corporations on the basis of inside information. This is still the situation in many other countries; it is considered to be a privilege of corporate status.

Before 1980, insider trading cases were prosecuted using Section 10(b) and Rule 10b-5, which prohibits a corporate insider from buying or selling shares in her own company based on non-public information. This is the basis for the traditional or classic theory of insider trading. The Misappropriation Theory extends insider trading cases to include people, beyond these employees, who trade on information which they are under a fiduciary duty to keep confidential. Any person, not just traditional corporate insiders, with material facts has a duty to either disclose this information or refrain from trading stocks.

### NONPUBLIC INFORMATION

Interestingly, the Misappropriation Theory began with a failure. Vincent F. Chiarella, a low-level employee at a financial printing house, was able to discern information relevant to company mergers and sales. He made investments based on the information he discovered and was convicted of securities fraud for trading on inside information. He won an appeal to the Supreme Court in 1980, with the justices ruling that he was not guilty because, not being affiliated with the company, he had no duty to other investors.

In a dissenting opinion, Chief Justice Warren E. Burger said Chiarella violated an obligation to his employer to keep its clients' secrets and had "misappropriated," or stolen, valuable nonpublic information. Within a year, the New York federal appeals court had upheld the conviction using the new Misappropriation Theory in a case involving securities trader James M. Newman. Newman's appeal to the Supreme Court went unheard.

In 1983, Anthony Materia, another low-level printing company employee, was convicted of inside trading in a civil suit brought by the Securities and Exchange Commission (SEC), under circumstances similar to those of Chiarella's case. A fiduciary duty to refrain from trading or providing information to others was found, in that doing those things would damage his employer's reputation and business. The court found that this duty was sufficient, even though the employer was not in any way involved with the securities that were bought or sold.

R. Foster Winans wrote a financial column in the *Wall Street Journal* which often affected the stock price of companies mentioned. In 1983 and 1984, Winans (and other brokers he told about the column contents) traded stocks in companies mentioned prior to the columns being published. He was fired from this action and for breaking conflict-of-interest rules, and was convicted of securities fraud using the Misappropriation Theory. The mail and wire fraud convictions were upheld by the U.S. Supreme Court in November 1987. However, the court split evenly on the securities fraud conviction. Because of the even split, this case will not set legal precedent but did lead many to believe the SEC needed to produce a clearer definition of insider trading. There was no tie-break vote because the court had one vacancy at the time.

James O'Hagan was a partner in a law firm which was to be local counsel for an attempted corporate takeover of Pillsbury Company. O'Hagan, who did not work on the takeover himself, bought shares and options based on conversations with another partner who did, prior to the announcement of the takeover. O'Hagan's conviction of mail and securities fraud was reversed by the 8th Circuit Court in a rejection of the Misappropriation Theory. This reversal was appealed, and with its 1997 opinion endorsing the theory in *U.S. v. O'Hagan*, "the U.S. Supreme Court has succeeded in both significantly extending the parameters of 'insider trading' liability and blurring the boundary line between permissible and impermissible trading activity." As the first time the Supreme Court endorsed the Misappropriation Theory, the decision allows the SEC the authority to impose criminal liability for fraud where there is no proof of a breach of fiduciary duty.

#### SEE ALSO

securities fraud; stock fraud; insider trading; Insider Trading Sanctions Act; mail fraud.

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## Mollen Commission

NAMED AFTER A FORMER deputy mayor of New York City, Milton Mollen, the Mollen Commission was created in 1994 to assess the extent of corruption in the New York City Police Department (NYPD). The 1980s saw a return to rampant misconduct by police officers after a purported decrease following the investigation by the Knapp Commission in the 1970s. The stakes had also escalated, moving from bribes and corruption related to vice, to huge sums of money generated by the crack cocaine trade.

Just as the NYPD was recovering from its battering at the hands of the Knapp Commission, Officer Michael Dowd and 15 to 20 fellow officers were found at the center of a criminal organization in Brooklyn. Dowd lived up to his billing as the most crooked cop in New York by continuing his illegal activities even after his arrest, reportedly corresponding with drug dealers from his jail cell. The Mollen Commission was formed one month after his arrest in an effort to determine why Dowd's superiors had not acted on 16 complaints that had been filed against him alleging that he had been taking bribes, robbing drug dealers, and selling cocaine over a period of six years.

The commission uncovered blatant corruption and cases of brutality, with officers in Brooklyn and Manhattan not only stealing and selling drugs, but sometimes shooting the dealers. The commission reported a "willful blindness" to corruption throughout the ranks of the NYPD. It further suggested that at least 40 corruption cases involving senior officers had been "buried" by the Internal Affairs Bureau, and that several previous police commissioners had been more interested in containing corruption scandals than containing corruption.

Heightened internal controls was one of two major recommendations of the Mollen Commission. The other was a proposal to increase external

controls, through the creation of a small police commission independent of the NYPD. That body would be empowered to perform continuous assessments of the department's systems for preventing, detecting, and investigating corruption, and to conduct, whenever necessary, its own corruption investigations.

#### SEE ALSO

Knapp Commission; police corruption; bribery; extortion; organized crime; drug trafficking.

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## money laundering

MONEY LAUNDERING is an old business, as old as any other illicit business. Not until recently has money laundering been seen as the problem that it really is.

The effects of terrorism have brought money laundering to the public's attention as terrorists are funded usually through laundered money, one way or another. Money laundering is a pervasive problem in the United States, and throughout the world. Over the past couple of decades it has become clear that money laundering is a robust, corrosive, all-consuming and dynamic activity that has far reaching consequences and effects.

In order to understand the issue of money laundering one must first understand what it is: Money laundering is the process by which someone conceals the existence, illegal source, or illegal application of income, and disguises that income to make it appear legitimate. Money laundering is the process of converting quantities of cash to a form

that can be used more conveniently in commerce and ideally conceals the origin of converted funds.

According to the Financial Crimes Enforcement Network (FinCEN) money laundering involves disguising financial assets so they can be used without detection of the illegal activity that produced them. Money laundering covers a vast array of illegal conduct. Anyone who gains money illegally must find a way to "clean" the money in order to use it in society. There are variations among the many different definitions; people view the crime of money laundering in several different ways.

Money laundering is basically the means used to convert funds that proceed from illegal activities, such as narcotics trafficking, prostitution, casino gambling, skimming, and many others, into financial uses that involve legal instruments. These instruments include bank deposits, investments in stocks and bonds, real estate, and others. Money gets into the banking system in a variety of ways: cash deposits over the counter, wire transfers from one bank to another, and letters of credit from legitimate businesses.

The laundering of money becomes effective when it penetrates the legitimate business world. Once money laundering infects the banking system, it opens the way for all kinds of illegal activities. The process of money laundering has devastating social consequences, as well as economic consequences. According to FinCEN, money laundering provides the fuel for drug dealers, terrorists, arms dealers, and other criminals to operate and expand their criminal enterprises. money laundering has the potential of eroding the integrity of financial institutions.

The term *money laundering* appears to have begun in the United States. It may have been Al Capone who began the using the term. During Capone's era, criminals were trying to hide the proceeds of their illicit businesses. In order to accomplish this task, laundrettes and car washes were often purchased in order to mix dirty money with clean money. Capone used a string of coin-operated laundromats in Chicago to disguise his profits from gambling, prostitution, racketeering, and violation of the Prohibition laws. The cash businesses provided a perfect opportunity to combine the proceeds of legal and illegal activity.

There appear to be four factors common in money laundering. First, the ownership and source of the money must be concealed. Second, the form

of the currency itself is changed. Third, the trail of the money laundering process must be hidden from beginning to end. Lastly, constant control must be maintained over the money laundering process itself. There are three distinct stages to the money laundering cycle. Initially there is immersion, which is consolidation and placement. The second step involves layering. Here, the money is separated from its original source. Money may be moved from account to account creating a diverse web of transactions, which are not easy to follow. Finally, the focus is on repatriation and integration. Here, the cleansed funds are brought back into circulation. Obviously the smaller the amount of money to be laundered, the quicker and easier the process.

### WORLD'S THIRD-LARGEST BUSINESS

The profits of crime that make their way into the financial systems throughout the world are staggering and problematic. Officials suggest that between \$200 billion and \$500 billion are laundered throughout the world each year. After foreign exchange and the oil industry, the laundering of money is the world's third largest business. The Financial Action Task Force (FATF) calculates that between \$400 and \$500 billion in drug money is laundered each year. In 1995, the sum of \$500 billion is equal to two percent of the total annual production of the world, and equal to the gross domestic product of Mexico. Clearly, money laundering is not only a criminal action, it also greatly affects the entire world economy.

Many people besides drug and arms dealers and terrorists launder money. Corporations launder money, in a sense, to avoid or evade taxes, to defraud shareholders, to get around currency control regulations, and to bribe prospective clients. Common citizens launder money in order to hide it from a divorcing spouse or to halt erosion of their assets. Governments may also launder money in order to subvert terrorists or to arm freedom fighters. Clearly a variety of individuals are involved in money laundering, at many different levels.

In the past few years, several factors may have led to the growth in money laundering. Globalization of markets and financial flows has increased dramatically due to the internet. The internet has basically established a single market, which allows money to be moved from country to country in mere seconds. Another factor is that there are no

real global anti-money laundering rules. Each country deals with the problem differently. In fact, some countries do not deal with the problem at all. Another factor leading to an increase in money laundering is poverty itself. Countries and people who are poverty stricken or have enormous debts may look for new economic opportunities. Offshore financial services offer a tremendous opportunity to struggling countries. The confluence of high technology, the global economy, and the secretive offshore banking centers has created a money launderer's dream. A simple click of the mouse on an individuals' computer can transfer huge sums of money within seconds. Some experts say the technology of international criminal activity is way ahead of any governmental response.

### REGULATION IN THE UNITED STATES

Increased regulations have made the laundering of money in the United States much more difficult. In addition, the United States enforces and prosecutes those individuals it suspects to be involved in this illegal activity. The toughening of anti-money laundering laws in this country has caused many criminals to look for alternative areas to hide their funds. Even though the United States expends great effort and money to deal with this problem, top U.S. officials admit that the enforcement system is fragmented and rather weak.

Prior to October 1970, people were bringing bags full of illegally obtained cash into banks for deposit. Often, questions were not asked of cash-loaded customers. These clients answered to no authority and were not investigated. Only until there was a violation of tax laws did anyone pay much attention to customer transactions. Obviously, the lack of scrutiny and law enforcement opened the door to wonderful opportunities for money launderers. Several important changes have taken place over the years since 1970.

In response to the abuse, Congress enacted the statute commonly referred to as the Bank Secrecy Act (BSA) which consists of two sets of provisions. The first set authorizes the secretary of the Treasury to require banks and other financial institutions to retain records to assure that the details of financial transactions can be traced if investigators need to do so. The second set of provisions authorizes the secretary of the Treasury to require financial institutions and in some other cases, other

businesses and private citizens to report financial transactions of certain kinds.

The most important aspect of the BSA are the reporting rules. A currency transaction report (CTR) must be filed for every deposit over \$10,000. The BSA has been amended many times since 1970. New amendments have given the Treasury Department a wider variety of regulatory tools to combat money laundering, especially since the BSA has historically had widespread non-compliance. In 1986, the Money Laundering Control Act was passed. This statute made money laundering a crime in its own right, and strengthened the BSA. In April 1990, the Financial Crimes Enforcement Network (FinCEN) was created by the secretary of the Treasury. Since its creation, FinCEN has sought to maximize information sharing among law enforcement agencies and its other partners in the regulatory and financial communities. In 1994, the agency was enhanced and given the BSA regulatory responsibilities.

Further strengthening the government's hand is the 1990 Depository Institution Money Laundering Amendment Act. This Act re-emphasized that the burden to report is clearly on the banks. In 1993, the Annunzio-Wylie Money Laundering Act was enacted which authorizes the government to require any financial institution, and its officers, directors, employees and agents, to report any suspicious transaction relevant to a possible violation of law or regulation.

In addition, this amendment to the BSA, also authorized the secretary to require financial institutions to carry out anti-money laundering programs, authorized special record-keeping rules relating to funds transfer transactions, and created the BSA Advisory Committee. Finally, the Annunzio-Wylie Money Laundering Act made operation of an illegal money transmitting business a crime, and enacted provisions requiring a re-examination of the charters of federally insured depository institutions convicted of money laundering.

In 1994 the BSA was again amended. The amendment came by way of the money laundering Suppression Act of 1994 (MLSA). This act required liberalization of the rules for exemption of transactions from the currency transaction reporting requirement. The act also authorized the Treasury Department to designate a single agency to receive reports of suspicious transactions from financial institutions. In addition, the act required all

money transmitting businesses to register with the Treasury.

In October 1994, the Treasury Department's Office of Financial Enforcement (OFE) was merged with FinCEN. This merger created a single anti-money laundering agency. In effect, it combined regulatory, intelligence, and enforcement missions. Since this merger, FinCEN has sought to streamline and simplify the BSA obligations of financial institutions. In addition, the reporting system has been reformatted to make the available data more useful for law enforcement investigations.

## PATRIOT ACT

President George W. Bush signed the Patriot Act into law on October 26, 2001. This act was created as a reaction to the terrorist attacks on September 11. Title III of this law is of particular concern to banks and other financial institutions as it deals with anti-money laundering and requires new areas of compliance, beyond the stipulations already in place. New requirements under the Patriot Act include the institutionalization of the "know your customer" procedures. In addition, heightened transparency requirements regarding correspondent relationships with foreign banks and private banking relationships with foreign individuals were added.

The most important aspect of the Patriot Act is that the regulations apply not only to banks and thrifts, but also to broker-dealers in securities and commodities, mutual funds, money services businesses (issuers, redeemers, or cashiers of travelers checks, money orders, or similar instruments, and money transmitters), operators of credit card systems, and casinos. A number of new businesses have been set up to aid financial institutions trying to comply with anti-money laundering rules, especially those established following the September 11 terrorist attacks.

With each new regulation, the need for such aid continues to grow. Banks, credit unions, investment houses, brokers and dealers outside of banks, and money-transmitting businesses have quickly looked to these new businesses for assistance. Even jewelers, car dealers, and travel agencies have new requirements meant to prevent money laundering.

The nature of fighting money laundering has obviously changed 2001. In the past, money laundering worried governments because it was used to



evade taxation and to hide the proceeds of other crimes. Even though these issues are still real, the new focus on money laundering surrounds the use of these funds for terrorism. Recently, the international community has pressured the world's 35 offshore centers to tighten their banking regulations, scrutinize their customers, and relax some secrecy laws. Many nations have signed treaties that allow for limited cooperation with foreign governments when drug money is involved. These efforts are not nearly enough.

#### SEE ALSO

drug trafficking; bank fraud; organized crime; United States; globalization; offshore entities; Bank Secrecy Act.

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## Morgan Grenfell Asset Management

WHEN ACCUSED Morgan Grenfell rogue trader Peter Young appeared for his court hearing in a red sweater, matching red skirt, black high heels, and red lipstick, it certainly made a great stir in London financial circles. How did the esteemed firm, British successor firm to the original J.S. Morgan and Co. and a component of the House of Morgan find itself in this ignominious position?

For over 100 years, Morgan Grenfell concentrated on the merchant banking business as established by Junius Morgan. Then, in an effort to keep current, the firm established a subsidiary, Morgan

Grenfell Asset Management. It was this successful subsidiary which was traumatized by a scandal involving the rogue employee.

Young established outsized positions in a number of speculative small companies, including in July 1995, Xavier, a small Canadian company with questionable investments in oil fields in southern Russia and western Siberia, and a \$30 million stake in a company called Solv-Ex, in March 1996. Solv-ex assets included plans to exploit Canadian Athabasca tar sands for oil through innovative chemical processing. Young's purchases came just the day before a report that the Federal Bureau of Investigation and the Securities and Exchange Commission were investigating Solv-ex due to the possible involvement of convicted stock swindlers, which triggered massive selling of the company's stock.

In fact, Solv-ex had been a speculative company for over a decade, and the efficacy of the company's touted new technologies was highly questionable. The promoters consistently used the traditional con man's technique of obfuscation: creation of so many conflicting reviews and outside analyst's reports that the truth was impossible to really determine, especially for the uninitiated.

Further damaging was the disclosure that Young had set up paired holding companies in order to circumvent British securities and investment regulations, which prohibit a single fund from owning more than 10 percent of any company. Morgan Grenfell became suspicious of the large quantities of unlisted shares, and concurrent with investigations by London regulators, the company shut down trading in three funds, until parent company Deutsch Bank (which had only recently purchased Morgan Grenfell) replaced the questionable assets with \$300 million in cash. However when trading resumed, investors removed \$400 million of assets. The estimated cost of this fiasco was perhaps \$800 million including fines and compensation paid to the government and investors.

Morgan Grenfell's own investigations began in September 1996. Most substantive issues took a back seat to the image of Young, the rogue trader in pantyhose. Many suspected him of putting on a show in order to get the charges against him dropped. However when he attempted self-inflicted castration, the court did find him mentally ill, and prosecutors eventually lost the case against indicted co-conspirators.

## SEE ALSO

stock fraud; securities fraud; Securities and Exchange Commission; United Kingdom.

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## Morgan, J. Pierpont (1837–1913)

J. P. MORGAN became the quintessential gentleman banker of the last quarter of the 19th century through a combination of inherited wealth, British connections, and a very Protestant version of *chutzpah*. J. P. Morgan and Co. was the American successor company to his father's J. S. Morgan of London, England, itself a successor to George Peabody, the first American merchant banker in London.

By the time J. P. Morgan took over, merchant bankers in the United States had become financiers who controlled not only business, but also government borrowing and financing, and Morgan was at the pinnacle of the group. Morgan prevailed in the railroad combines and railroad bond debacles of the 1870s and 1880s. In 1901, Morgan engineered the conglomerate that became U.S. Steel, made up of John D. Rockefeller mines and shipping companies, and Andrew Carnegie steel enterprises. The new company was patterned on a vision spun by young Charles M. Schwab, at the time an aide to Carnegie.

Political, ethnic, and religious differences among bankers permeated Wall Street, just as it did the rest of American society. Morgan's competitors included Jacob Schiff, the firm of Kuhn Loeb, Goldman, and Joseph Seligman. Just as Morgan was a conduit for British investment capital, and represented British investors, the "Jewish bankers" had

access to German and French money. Morgan biographer, Ron Chernow asserts that "Pierpont's anti-Semitism was well-known," although Morgan later signed a protest when Seligman was barred from a fashionable Saratoga, New York, hotel.

When a panic, sparked in part by speculation in mining and railroad stocks, threatened to deplete the U.S. gold supply in 1895, Morgan brought together the financiers of the age, forming a syndicate which purchased \$62 million in gold from Europe and traded it to the government in exchange for U.S. bonds, thus, reinforcing the gold reserves of the United States and propping up the gold standard.

President Grover Cleveland's own Democratic party was heavily allied with the Populists at the time. His enemies immediately portrayed this as yet another deal with the controlling interests on Wall Street. It did not help that the bankers had, in turn, sold the bonds at a handsome profit. Ironically, while the Populist rhetoric hinted at a conspiracy of Jewish bankers, Morgan represented the solidly Anglo-Protestant elite.

While Morgan professed a high regard for the public interest, he was perfectly capable of participating in market "corners" as he did with E. H. Harriman in the great Northern Pacific corner of 1901. Morgan had financed James J. Hills's purchase of the Chicago Burlington and Quincy railroad, consolidating it with his Great Northern and Northern Pacific. Fearing the trans-continental competition, Harriman sought to buy a stake in the new combine, and when rebuffed, set about secretly buying up \$78 million in Northern Pacific shares. To protect their assets, Morgan and Hill began buying the stock themselves. With three bankers buying, the Northern Pacific stock kept rising, even as short-interest grew with every speculator on Wall Street expecting an imminent collapse. Every other stock on the market sank, as speculators were forced to sell other stock to maintain their positions. From 73 on May 4, the stock shot up to 1,000 before the entire market crashed. "Giants of Wall Street in fierce battle may precipitate crash that brings ruin to hordes of pygmies!" screamed the *New York Herald*, echoing the fears of the man on the street. Yet, President William McKinley, elected as a supporter of business, ignored public concern.

Then on September 6, 1901, McKinley was assassinated, and Morgan had to deal with Teddy Roosevelt. Morgan's "finest hour" came as a finan-

cial panic loomed in 1907. Wall Street had been expecting it. Averted in the spring, it finally came in October.

Morgan again mobilized New York's banking and finance elite to avert total economic collapse. Morgan would have said that his actions in limiting the damage on Wall Street stemmed from his deep sense of obligation to be of public service. Yet, one end result was the convenient acquisition by Morgan's U.S. Steel of the assets of the Tennessee Coal, Iron and Railroad Co. (TC&I) headquartered in Birmingham, Alabama, one of the few remaining independent steel producers.

Morgan organized the U.S. Steel trust in 1901 as an efficient, national industry that would eliminate wasteful duplication. It had begun in 1898 with the organization of Federal Steel from a number of smaller steel companies, the Minnesota Iron Company, and two railroads. In 1901, Morgan purchased all of the assets of Carnegie Steel as the centerpiece of the new trust, paying \$480 million, more than the annual budget of the U.S. government. The new concern was capitalized at \$1.4 billion.

The proximate cause of the 1907 panic was a failed attempt by speculators F. Augustus Heinze and Charles W. Morse to corner the stock of United Copper. The failure of the corner itself bankrupted a mining company, two brokerage houses, and a bank. But the worst was yet to come. Heinze and Morse had financed their run on the stock with loans from several New York trust companies. Trust companies at the time were a kind of unregulated state-chartered institution that functioned like a commercial bank, but with no reserve requirements. When news of the involvement of the Knickerbocker Trust spread through New York, depositors tried to withdraw their money.

The city's bankers met the demands of Knickerbocker's depositors for a few days, hoping to avert a wider panic. Morgan returned from the Episcopal Convention on Saturday, October 19, to meet the crisis, putting together a committee of leading bankers and financiers.

But by Tuesday, the team agreed to let Knickerbocker fail, setting off the wider panic. As the week progressed, Morgan took charge of impromptu committees of bankers, which he charged with raising the millions necessary to stabilize the trusts, brokerage houses, and banks, all reeling from the pressure to cover margin loans as stock prices sank. In effect, Morgan played the role of central banker

at a time when there was no national banking or reserve system.

It was near the end of the panic, that Grant Schley of the brokerage firm Moore and Schley, one of the largest on Wall Street, announced his imminent personal and business failure to Morgan and his team of bankers. Schley had used the securities of the TC&I as collateral for more than \$35 million in loans, valuing the stock at \$130 a share. But as the panic progressed, there was no market for any of the shares at that price. Morgan and U.S. Steel always maintained that they had done a favor for Schley and the markets by buying out the TC&I stock at \$100 a share, a total of \$30 million. The company was poorly run, not very profitable and its assets overvalued, they said.

But it was this transfer that gained the most ire from a country that had little understanding of banking or financial systems. While the transaction, approved by Roosevelt in advance, had put an end to the panic, Senate and House committees held highly publicized investigations in 1909 and again in 1911.

The experience of the 1907 panic led to the call for the establishment of a rudimentary monetary system. However, the establishment of the Federal Reserve did not become a reality before Morgan's death in Rome, Italy, at the age of 75 in 1913.

#### SEE ALSO

U.S. Steel; antitrust; Roosevelt, Theodore; Rockefeller, John D.; robber barons; antitrust; Roosevelt, Theodore.

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## Morton-Thiokol

MORTON-THIOKOL is best known for its role in the explosion of the space shuttle *Challenger* on January 28, 1986. In 1973, Thiokol Chemical Corporation (later the company became Morton Thiokol, Inc.) was awarded an \$800 million contract to manufacture solid rocket boosters for the National Aeronautics and Space Administration (NASA)



*Morton-Thiokol tests a redesign of the solid rocket booster after the explosion of the space shuttle Challenger.*

space shuttle program. The faulty O-ring seals developed by Thiokol ultimately failed in the right side solid rocket booster and caused the explosion of the spacecraft.

A subsequent investigation by the President's Commission on the Space Shuttle *Challenger* Accident, 1986, (the Rogers Commission), concluded that the failure of the O-rings and field joint was the primary cause of the *Challenger* explosion.

Early tests conducted by Thiokol indicated severe problems with the field joints on solid rocket boosters. Instead of closing and preventing the seepage of gases, the field joints were open and allowed hot combustion gases to leak and erode the O-rings. The erosion of the O-rings would necessarily cause the joints to explode, destroying the entire booster in the process as well as the spacecraft.

The failure of the field joints even destroyed secondary or failsafe O-rings. NASA's Marshall Space Flight Center classified the O-ring seals as Criticality 1, meaning they did not meet space shuttle requirements for failsafe standards. As such, the O-rings were considered extremely hazardous because they were subject to metal erosion, burning, and explosion.

Several Thiokol engineers openly expressed their concerns about the potential catastrophic costs associated with the faulty O-rings. One engineer, Roger Boisjoly, wrote a memo expressing these concerns about the O-rings and strongly

urged the company to develop a team dedicated to quickly solving the problems. A task force was formed to investigate problems with the O-rings and field joints. However, they never reached a conclusion or solution to the problem primarily because of a lack of resources and reluctance by management to fully investigate the problem.

At the time, the company was in the process of renegotiating its contract with NASA. Seriously researching and resolving the O-ring problem most likely would have resulted in a lengthy delay of the shuttle launch, jeopardized the potentially lucrative second contract with NASA, and ultimately adversely affected Thiokol's profits. Eventually, Thiokol requested that NASA consider the O-ring problem resolved and just five days before the *Challenger* launch, officials at Marshall considered the matter closed.

Beyond erosion problems, Thiokol engineers also had knowledge that cold weather conditions severely affected the ability of the O-rings to effectively compress and contract and therefore seal out hot gases. The day before the *Challenger* launch, Thiokol engineers were concerned about the unexpectedly low temperatures at the Kennedy Space Center in Florida and contacted NASA officials to discuss the potential hazards of launching under cold weather conditions. Thiokol engineers recommended that the launch be delayed and not take place until weather conditions were about 53 degrees Fahrenheit.

This recommendation was not well received by NASA officials who were adamantly opposed to any further delays and Thiokol's conclusions regarding temperature levels. In this respect, Thiokol was under tremendous pressure to change their launch recommendation. Despite strong objections from Thiokol engineers, officials at the company reversed their position and approved the launching of the *Challenger*.

At the time of the launch, the temperature had reached a low of 36 degrees Fahrenheit and there was ice build-up on the launch pad. The *Challenger* tragically exploded only 73 seconds after launch, killing seven crewmembers including a schoolteacher, Christa McAuliffe, who was to conduct a lesson for her students from space.

#### SEE ALSO

*Challenger* Disaster; unsafe products; corporate criminal liability; whistleblowers.

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## multinational corporations

AN INTERNATIONAL corporation is one which pursues business activities in one or more countries other than its home country. A multinational company is one in which a significant proportion of activities occur away from the home country. A global company is one which does not recognize a home country, but which conducts its activities on the basis of whichever location happens to be the most appropriate and efficient. In each of these cases, the organization is motivated by profit and considers activities in countries where they can obtain either new resources or new markets.

Multinational corporations first emerged as early as ancient Assyria and Mesopotamia, when overseas trading ventures were organized by partnerships of private individuals and facilitated by state governments. With people moving away from their homelands for trade, the influence of foreign ideas and customs and the absence of moderating home influence led many to behave in ways which would not be considered appropriate or legal at home. This has included not just marital infidelity and immoderate behavior, but mistreatment of workers, dishonesty in dealings, and the deliberate sale of goods of unacceptable quality.

In subsequent centuries, multinational companies became identified with the idea of colonization and the expansion of mainly European empires into third world areas. As a result, multinational corporations such as the British and Dutch East India Company, among others, were granted privileges by their home governments that enabled them to use military means to obtain desired markets and resources. This license allowed corporations and

their representatives ample opportunity to benefit from fees, fines, and compensations paid by defeated states to the victorious corporations, as was the case with Robert Clive and the East India Company in defeating the Moghul Empire in India.

The creation of multinational companies in support of colonial empires enabled truly international trading networks on a large and stable basis. One of the most well-known was the triangular trade in rum, molasses, and slaves connecting New England, the Caribbean, and Africa. Another network of international trade, which would now be considered illegal, involved the forced importation of opium into China by British companies in return for Chinese silks and precious goods.

The 19th and early 20th centuries saw an intensification of international trading and business activities, with the growth of industry improving transportation and communication links lending great assistance to cross-border activities. Investors, particularly in London, England, and other great financial centers, were able to establish sophisticated portfolios of investment. The railroad era for the first time necessitated the creation of private networks of capital for use domestically; previous networks had been supported or facilitated by states through the formation of empire.

This process was halted by World War I and greatly hampered by the subsequent retreat away from free trade and toward tariffs that followed. Subsequently, the Great Depression of the 1930s had a huge worldwide impact because of the reach of international companies. However, this period did witness a number of important international agreements which facilitated the growth in importance of multinational companies. World War II offered the opportunity for the Allied Powers to try to redefine the international economic system and avoid the chaos that had marked previous years. This was attempted through the creation of the Bretton Woods system, pegging currencies to the dollar, the establishment of the World Bank and the International Monetary Fund, together with the inauguration of the General Agreement on Tariffs and Trade.

At the same time, the desire to create an architecture of international order to prevent such terrible warfare from recurring contributed to the stability of international relations and hence the ability of corporations to undertake international business. The subsequent creation of trading blocs

such as the European Economic Community in 1957 further contributed to this process. In addition to internationalization becoming more convenient, it also features the increasingly rapid dissemination of business knowledge and common business systems around the globe. This has included not just awareness of the skills and competencies necessary to be an effective manager but, also, common standards in such fields as accountancy and financial regulation. These have both resulted from and stimulated further internationalization, as well as more tortuous governmental negotiations.

These international arrangements have made it much harder for companies in certain industries to maintain the cartels they had previously operated, although it is still difficult to tell whether firms are acting similarly for sound business reasons or because of collusion. Legislation in a number of countries has outlawed cartel activity, which was seen as axiomatic of business people by economist Adam Smith. However, improvements in global communications and transportation have made transfer pricing (in which members of a single multinational firm sell inputs to each other at non-market prices to avoid tax) and dumping (deliberately undercutting competitors in some markets by selling at reduced prices, or even below production costs) more prevalent activities.

Since the late 1970s and 1980s, the Western world has undergone something of an ideological change with much greater credence being placed on the value of markets in regulating activities and in monitoring the behavior of actors within them. This has meant the progressive deregulation of business, the lowering of corporate rates of taxation, and the increasing willingness of government agencies to do as the business sector would wish them to do. Inevitably, this has led to occasions of corruption and crime, and challenges to definitions

of what is considered to be acceptable and legal. The close collaboration between the U.S. government and U.S. corporations in the rebuilding of Iraq in 2004 is one example of this, as is the U.S. support in multilateral trade agreements of genetically modified food technology in which U.S. corporations have a significant interest.

At the same time, growing awareness among consumers and communities at large of the impact of business upon the environment and of the activities of corporations, together with the increased ability that people have to organize themselves through information technology, have provided an important counterweight to corporate power, with many forced revelations of practices concerning sustainable development and of executive compensation. Non-governmental organizations (NGOs) such as Greenpeace have been very active in revealing environmental mismanagement, such as happened with Union Carbide's chemical pollution in Bhopal, India, while Amnesty International and the International Labor Organization (ILO) have paid attention to abuses of human rights by some companies, as well as the use of child labor and other abuses of workers.

#### SEE ALSO

Greenpeace; Union Carbide; capitalism; globalization; global warming; labor crimes; Asia; South America.

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# N

## 19th-century regulation

THROUGHOUT THE 19th century, change characterized every aspect of life in the United States. The economy changed from a nation of farmers and shopkeepers living in small towns to a country where one out of three people lived in a city, and instead of working for themselves worked in a factory for a wage. Lawmakers responded to these economic changes in two very different ways.

From 1830 to 1890, the U.S. government promoted economic development enacting legislation that benefited the growth of business, particularly big business. Beginning in 1890, lawmakers responded to public outrage at big business by a changing its emphasis from promotion of economic activity, to one of regulation based on an increasingly bureaucratic model of public policy.

Many scholars characterize the governmental response to industrialization as *laissez-faire* capitalism. *Laissez-faire* refers to the government policy of letting the market regulate business without the interference of the government. The question was not whether there should be economic growth, but how that economic growth should be managed, and for whose benefit: business or the workers? During the last quarter of the 19th century, industrialization and urbanization generated enough social pressure that government policy, in particular the Congress,

diverged from its policy of *laissez-faire* to a policy of limited regulation.

### PROMOTING BUSINESS

Taking control of Congress in the 1860s, Republicans embraced policies and programs that promoted economic enterprise. Congress extended massive subsidies to transcontinental railroad developers through land grants. The Pacific Railroad Bill of 1862 granted enormous amounts of federal land to the Union Pacific-Central Pacific Railroad, the first of the transcontinentals.

Congress passed other measures that promoted economic enterprise, including the Morrill Land-Grant Act, a law that donated 30,000 acres of federal land to every state for each of its Senators and Representatives. These and other promotional activities were dramatic evidence of federal intervention in the economy.

State legislatures and local governments promoted business by adopting laws and policies favorable to business. For example, some states in the 1870s realized they could make themselves attractive to big business by offering a corporate charter that provided broad powers. The states of Delaware, West Virginia, and New Jersey offered such charters. During the 1870s, however, most direct and local aid came to a gradual end. Large-scale

bankruptcies, swindlers, and defalcations on bonds following the depression of 1873, and helped put to an end many of the state programs designed to promote business.

Industrialization and urbanization released social changes that this traditional distributive scheme was incapable of accommodating. Third parties and social reform movements launched an attack on distributive politics by offering a new view of law and legal institutions designed to serve disaffected social constituencies. For example, the Populist Party traced the severe economic distresses caused by industrialization to the growing control of large corporations, especially railroads, over government. Opposition to distributive politics also came from the social elite of the cities (professionals, intellectuals, and old money), known as mugwumps, who pushed for reform of urban politics, the introduction of the secret ballot, and scientific corporate management rather than partisan management by government.

Through the last quarter of the 19th century, the states were the center of regulatory activity limiting corporate enterprise, protecting children and women laborers, and forming bureaus and independent regulatory commissions. As the economy became more national in scope, regulatory authority moved to the federal government.

## STATE AND FEDERAL REGULATION

State regulation grew in response to the railroad. Massachusetts, in 1869, passed legislation giving its pre-Civil War railroad commission general supervision of all railroads, with authority to examine them and to make certain they complied with the law. The commission, as was typical of most early state regulatory bodies, had the power to set rates or to enforce what it deemed reasonable rates. Its role was strictly advisory. In most states with commissions, state legislatures retained the right to review and change any decisions of the railroad commission. As a result, state railroad commissions were subject to political influence of the railroad financiers.

The Industrial Revolution also prompted changes in the workplace and in the structure of the labor force. These enormous changes were translated into two separate developments. The first was an increasing incidence of violent confrontation between labor and capital. A cut in wages, for exam-

ple, by the Baltimore and Ohio Railroad in 1877, precipitated nationwide rioting that culminated in the destruction of millions of dollars worth of railroad property. Unionization was the second response to industrialization. Just as capital sought to mobilize its resources, labor gradually accepted that it, too, would have to bring its collective power to bear.

State legislatures responded to developments in the labor market in often contradictory ways. On the one hand, the violence associated the labor movement was translated into harsh anti-union statutes. An 1885 Alabama law banned boycotts and picketing that blocked strikebreakers. The fear of social disorder that attended the labor movement was also a stimulus for reform.

Several states outlawed the blacklist, which employers used to keep union members, once fired, from being rehired. The "yellow dog" contract, which pledged a worker as a condition of employment not to join a union, was also outlawed in several states but persisted in others until the New Deal of the 1930s. Other statutes forbade paying workers in scrip (a certificate constituting a kind of money) and required regular paydays.

The regulatory efforts of Congress after the Civil War were tentative and often contradictory, pulled as they were, on the one hand, by the nationalizing forces of the economy and, on the other, by a traditional respect for the rights of the states and the democratic impulse of the era's mass two-party system. Congress was a political institution in an era in which party politics dominated legislation.

## ADMINISTRATIVE AGENCIES

The late 19th century response to economic consolidation was the administrative agency, a hybrid governmental institution that combined executive, legislative, and judicial functions. These bodies were separate from both the legislature and courts. Yet they legislated, in that they adopted regulations that had the force of law; they also adjudicated in that they held hearings and rendered quasi-judicial opinions. This "fourth branch" of government, nowhere mentioned in the Constitution, exercised delegated powers from the legislature, fulfilling on a day-to-day basis the oversight functions of regulation that a legislative body was incapable of doing.

The two most important early federal regulatory measures were aimed at the new economy's



most vital elements: railroads and manufacturing. The Interstate Commerce Commission (ICC) of 1887 and the Sherman Antitrust Act of 1890 reveal the mix of political and administrative solutions to the problems created by economic growth. Congress kept one foot in the old world of distributive politics, while stepping tentatively into a future of administrative regulation. The end result was an incoherent, unworkable policy from which no one benefited.

The ICC reflects the tentative policy of Congress toward regulating and reforming business practices. Only after the Supreme Court struck down an Illinois railroad regulation, in *Wabash, St. Louis & Pacific Railroad Company v. Illinois* (1886) did Congress enact legislation creating the ICC. This case struck the death knell for state regulation of railroads. The Interstate Commerce Act addressed the problem of railroads charging different customers different prices for the same service. The ICC Act provided that all customers had to be treated in a similar fashion and required that all charges be reasonable and just.

Congress created a commission of five members to hear complaints about railroad practices and to undertake investigations on its own initiative. The president appointed the members of the commission with the advice and consent of the Senate, and they served staggered terms at the pleasure of the president for a maximum of six years. No more than three commissioners could come from the same political party, diminishing fears of partisan control of commission policy, but falling short of the reformers' demands for apolitical experts.

Congress essentially paralyzed the ICC by demanding that the ICC balance the interests of too many parties, which resulted in deadlock and inactivity. Despite its shortcomings, the original ICC was an important event in the history of 19th century law in the United States. It provided the building block upon which the administrative state of the 20th century subsequently arose.

Congressional response, in the form of the Sherman Antitrust Act, to the problem of economic competition reflects the ambivalence with which Congress and the American people viewed direct governmental intervention in the market. However, both Congress and the American public recognized the genuine threat of monopoly power to the economic order of free enterprises created by new conglomerates, such as John D. Rockefeller's

Standard Oil. Both Congress and the American people feared that if a single company was able to monopolize, or drive all other companies out of business that sold the product, consumers would be forced to pay a higher price for the product.

#### THE PROBLEMATIC SHERMAN ACT

The Sherman Antitrust Act declared that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states or with foreign nations, is hereby declared illegal." The act created no administrative structure, as had the Interstate Commerce Act; instead, the task of enforcement fell to the Department of Justice and federal courts. Violators were susceptible to fine, imprisonment, and, in the case of corporations, dissolution. The lack of administrative structure reflects Congressional intent to both regulate and promote. This ambivalence is reflected in the fact that the Sherman Act does not ban all corporate combinations.

The Sherman Act was problematic in another way. While the act covered transportation of goods across state lines, there was at least reasonable debate about whether manufacturing (the production of goods, even by a corporation that operated in several states) was encompassed within the statute and the commerce clause of the Constitution. Manufacturing had traditionally been treated as a local enterprise, the control of which properly belonged to the states. But the rise of an industrial market economy of transcontinental proportions posed difficult regulatory problems for the states.

The overwhelming support for the measure, which passed the Senate by a vote of 52 to 1 and by voice vote in the House of Representatives, suggests that critics thought the Supreme Court would nullify it. In any case, in a pattern repeated throughout the legal history of the United States, members of Congress were willing, given the diverse political pressures that played on them, to permit the federal courts to give meaning to the nation's first and most important antitrust act.

#### SEE ALSO

Sherman Antitrust Act; antitrust; Interstate Commerce Commission Act.

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## Nader, Ralph (1924–)

CONSUMER ADVOCATE, lawyer, environmentalist, feminist, and presidential candidate, Ralph Nader has forged a unique place in American culture and politics. Nader was born in Winsted, Connecticut. He graduated from Princeton University in 1955 and earned a law degree from Harvard in 1958. After practicing law for a brief period in Hartford, Nader arrived in Washington, D.C., in 1963 to work for Daniel Moynihan, the assistant secretary of labor. Nader wrote numerous articles for such diverse publications as *The Nation* and the *Christian Science Monitor*.

Pursuing an interest developed at Harvard, Nader also served as a voluntary adviser to a Senate subcommittee investigating automobile safety. He soon developed a special interest in the Corvair produced by General Motors (GM). Consumers who had bought the Corvair between 1960 and 1963 had filed 106 lawsuits against General Motors for a total of over \$40 million.

The chief problem with the Corvair was that ignition switches sometimes stuck causing drivers to lose steering control. In his book, *Unsafe at Any Speed: The Designed-In Dangers of the American Automobile*, Nader used his skills as a lawyer to prepare a scathing indictment of GM in such a way that he was safe from legal actions that GM could take against him.

Since GM had no legal grounds to go after Nader, they hoped to discover something that

would discredit him. GM hired two private detectives to follow him. When Nader discovered the detectives, he sued GM for violation of privacy, and the huge corporation was forced to publicly admit its guilt. Nader received a \$425,000 settlement, most of which he used to create the Public Interest Research Group (PIRG) to serve as a permanent watchdog for consumer interests. By May 1969, when GM stopped producing the Corvair, Nader had become a household name of consumer advocacy.

In June 1968, Nader gathered a group of seven young lawyers with similar watchdog interests who became known as Nader's Raiders. The following summer, Nader selected 200 applicants for Nader's Raiders from a pool of 30,000 applicants and targeted the Interstate Commerce Commission (ICC). Nader sent the young lawyers into various corporations and agencies to get information to protect workers, taxpayers, and the environment.

In 1969, Nader set out to make automobile tires safer. He had evidence that the polyester used in the production of tires was likely to cause dangerous failures on the open road. His research revealed that tire manufacturers were withholding information in advertisements for their products, including the results of road tests that indicated safety problems. Additionally, it was revealed that tire manufacturers were recouping their losses from recalled tires by using loopholes in existing laws to recycle the tires by selling them abroad.

Nader forced General Motors to agree to release results of tests when consumers requested them, engineered truth in advertising of tires, helped to close loopholes in laws, and lobbied for the rights of consumers to file class-action lawsuits against tire manufacturers. Even Congress was not sacred to Nader. In 1971, in his magazine article, “Making Congress Work,” Nader accused Congress of being too heavily influenced by lobbyists and other special interest groups and contended that they were unable to check the abuses of campaign finance. More than 30 years later, campaign finance and its regulation remain top concerns for the U.S. public and Congress.

Beginning with his 1965 attack on General Motors, Nader has been instrumental in achieving improvements in automobile safety, including laminated windshields, collapsible steering assemblies, enhanced door locks, shoulder harnesses, head restraints, safer tires and fuel tanks, and auto-

mobile recalls. Additionally, Nader's consumer watchdog role has focused on nuclear power, tax reform, meatpacking, education, banking, communications, and rights for consumers, workers, nursing home patients, the elderly, the disabled, and airline passengers.

## ENACTING LAWS

Nader, along with supporters and other independent organizations, successfully lobbied Congress to enact the National Traffic and Motor Vehicle Safety Act of 1966; the Wholesome Meat Act of 1967; the National Gas Pipeline Safety Act of 1968; the Radiation Control for Health and Safety Act of 1968; the Coal Mine and Safety Act of 1969; the Truth in Lending Act of 1968; the Fair Credit Report Act of 1970; the Occupational Safety Act of 1979; the Fair Credit Billing Act of 1974; the Equal Credit Opportunity Act; the Fair Credit Report Act; the Fair Credit Billing Act; the Clean Air Act; and the Freedom of Information Act.

The consumer protection agencies that Nader has founded include the Center for the Study of Responsive Law, the PIRG, the Center for Auto Safety, Public Citizen, the Clean Water Action Project, the Disability Rights Center, the Pension Rights Center, and the Project for Corporate Responsibility. He has also worked with others to form a number of other consumer protection groups.

In the 2000 election, one of the closest presidential elections in history, Nader garnered 2,858,843 popular votes (2.74 percent). Some analysts argued Nader took votes away from Democratic candidate Al Gore, allowing Republican George W. Bush to win the presidency amid bitter controversy. After the election, Nader returned to watchdog interests. In 2002, after reading an article in the *Washington Post* about the financial problems of the District of Columbia's public library, he set out on a rescue mission. In 2003, Nader chose the accounting profession as his target and formed the Association for Integrity to monitor the activities of the Securities and Exchange Commission (SEC) and various other regulatory agencies.

## SEE ALSO

*Unsafe at any Speed*; Corvair; Truth in Lending Act; consumer deaths; automobiles; corporate liability; unsafe products; Securities and Exchange Commission; campaign finance.

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## National Association of Securities Dealers

THE NATIONAL Association of Securities Dealers (NASD), which operates subject to Securities and Exchange Commission (SEC) oversight, is the largest self-regulatory organization in the United States, with a membership that includes virtually every broker-dealer in the country that does a securities business with the public. The NASD develops rules and regulations, conducts regulatory reviews of members' business activities, and designs and operates marketplace services and facilities. Established under authority granted by the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934, Congress established a system of self-regulation for securities brokers and dealers paralleling those earlier created for the securities exchanges.

Under federal law, virtually every securities firm doing business with the American public is a member of this organization. Roughly 5,300 brokerage firms, over 93,000 branch offices, and more than 664,000 registered securities representatives come under its jurisdiction. NASD carries out its regulatory responsibilities through a variety of activities.

First, NASD registers and tests securities professionals. Second, it conducts onsite examinations of securities firms to determine their compliance with federal securities laws. Third, NASD oversees the rules of the Municipal Securities Rulemaking

Board and NASD rules and regulations. Fourth, the NASD performs continuous automated surveillance of the markets operated by The NASDAQ stock market. Fifth, it reviews advertising, sales literature, and underwriting arrangements proposed by securities firms in connection with new securities offerings. Sixth, the NASD enters into cooperative programs with governmental agencies and industry organizations to solve problems affecting investors, public companies, and securities firms.

NASD also offers a variety of services, including arbitration and mediation to enable investors and broker-dealer firms to resolve disputes, and telephone inquiry service to provide investors with background information on securities firms and their sales personnel. Governance of NASD is provided by a board composed of an equal mix of public representatives and industry professionals.

### NASD EXAMINATIONS

All NASD members are subject to field examination by NASD. NASD members are examined either annually or periods of up to once every four years depending on the nature of the firm's business activities, method of operation, and type of products sold. NASD reviews both the financial and operational condition of the firm, as well as its sales practices. During a routine examination, a member's books and records are examined for currency and accuracy. Sales practices are reviewed to determine whether the firm has dealt fairly with customers when making recommendations, executing orders, and charging commissions or markups and markdowns. Routine examinations also seek to determine member compliance with anti-fraud provisions of the Securities Exchange Act of 1934, the Securities Act of 1933, the NASD advertising rules, and Regulation T of the Federal Reserve Board which governs the extension of credit (margin) by brokers and dealers.

In addition to routine field examinations, NASD conducts thousands of investigations each year involving matters such as customer complaints, terminations of registered persons for cause, financial problems, and questionable sales practices or fraud. NASD's market regulation employs a number of sophisticated computer systems to monitor trading on the Nasdaq stock market. Among these is the Nasdaq Equity Audit Trail, which provides a fully integrated database of sec-

ond-by-second quotations, transactions, and clearing detail for all NASDAQ securities on a firm-by-firm basis. The historical record of trading in NASDAQ securities is used in a broad range of NASD surveillance systems, and provides an efficient and effective means of overseeing ongoing trading activity in the NASDAQ market.

### NASD PENALTIES

NASD disciplinary procedures are not designed to recover damages or to obtain relief for any party. Instead, they are used to promote membership compliance with high standards of commercial honor, and just and equitable principles of trade by appropriately penalizing those who fail to comply. Depending on the nature of the violations, NASD may sanction a member or an associated person by imposing any one or more of the following penalties: censure, fine, suspension or expulsion of a firm from membership in the NASD, or the suspension or revocation of a person's license to sell securities. NASD's disciplinary procedures provide appropriate rights of appeal. The SEC also receives and may review NASD final decisions if disciplinary action has been taken against a member or an associated person.

Any securities professional associated with a member firm including partner, officers, directors, branch managers, department supervisors, and salespersons must register with the NASD. The registration application requires information about the individual's prior employment and disciplinary history. The NASD and five other self-regulatory organizations, along with 13 member firms, developed a continuing education program that is uniform across the securities industry. NASD evaluates members' communications with the public to assure that they are fair and not misleading. These communications might consist of advertisements, as well as brochures, form letters, or research reports. NASD regulations require members to submit for review certain communications with the public, such as mutual fund sales literature or advertising.

New members must file all advertising prior to use for a period of one year, and NASD investigates customer complaints involving member communications with the public, and conducts periodic spot checks of material that is not required to be filed on a routine basis.

## SEE ALSO

securities fraud; Securities and Exchange Commission; stock fraud; accounting fraud; fiduciary fraud.

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## National Highway Traffic Administration

THE NATIONAL HIGHWAY Traffic Safety Administration (NHTSA) is responsible for “reducing deaths, injuries and economic losses resulting from motor vehicle crashes,” through the means of “setting and enforcing safety performance standards” as well as “providing grants to local and state governments to enable them to conduct effective local highway safety programs,” according to its public relations literature.

Following a decade-long period of rising traffic casualties, increased public outcry, and the publication of Ralph Nader's *Unsafe at Any Speed*, in 1966 Congress held a series of hearings to determine whether a regulatory agency for traffic safety should be created. In passing of Highway Safety Act, the National Highway Safety Bureau was established, which in 1970 became the National Highway Traffic Safety Administration under the newly established Department of Transportation. Joan Claybrook, who would later go on to run Nader's consumer advocacy group, Public Citizen, was chosen to be the automotive and traffic safety bureau's first administrator.

With an annual budget of \$434 million and with more than 600 employees, the NHTSA has a multi-faceted approach to ensuring drivers' safety. In addition to routinely recommending recalls and creating programs to educate the public, the administration publishes valuable statistics through its subdivision, the National Center for Statistics and Analysis, which informs the public on the precise danger that lies on America's roads.

## AUTOMOTIVE RATINGS

The administration also contains a subdivision called the New Car Assessment Program, which rates, on a five-star scale, the frontal, side, and rollover resistance protection of hundreds of motor vehicles by make, model, and year. About three car models per year receive a five-star rating in every category.

In conjunction with the Environmental Protection Agency (EPA), The NHTSA regulates the Corporate Average Fuel Economy (CAFE), a statistic that sets the standard for fuel economy, which is defined as the average mileage possible of an automobile per one gallon of gasoline. Fuel economy is separated to consider terrain: there is a city mileage average and a highway mileage average.

The NHTSA and its Resource Center publish annually the *Traffic Safety Materials Catalog*, a publication containing topics of information ranging from air bags to youth safety. As with most government publications, all of the information contained in the publication is available free to the public on request.

In 2004, the NHTSA reported that since its inception, the bureau has recalled over 300 million cars, trucks, buses, motorcycles, child seats, and other motor vehicle-related products due to safety defects, or simply not complying with a Federal Motor Vehicle Safety Standard.

## SEE ALSO

Nader, Ralph; *Unsafe at Any Speed*; automobile; Corvair; Ford Pinto.

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## National Medical Enterprises

ORIGINALLY A PRIVATE California-based healthcare chain, National Medical Enterprises (NME) expanded quickly during the early 1980s and operated psychiatric hospitals throughout

many areas of the United States, but primarily in Texas. As a for-profit private company traded publicly on the stock market, NME was driven to succeed financially. During times when insurance companies and employers across the United States increasingly funded psychiatric, alcohol, and drug treatment services, the opportunities for NME to profit were many.

By the end of the 1980s, however, some alarming accusations and reports were circulating about NME. In 1985, NME was accused of bribing political officials. By 1991, rumors attributed NME's massive profits to unethical conduct, exploitation, and lies. During a televised special the same year, one of NME's senior executives, Dr. Robert Stuckey, acknowledged that if an insurance company would pay \$10,000 for alcoholism treatments and \$50,000 for depression treatments, company doctors were instructed to change diagnoses to depression.

In the aftermath of Stuckey's comments, many former NME patients came forward with stories of abuse, fraud, and misery. Senator Mike Moncrief of Texas initiated a Senate inquiry. A settlement was reached between the Texas attorney general's office and NME, resulting in a \$10 million penalty, which was the maximum fineable amount.

Still, NME attempted to maintain and expand its hospital chain and continued to bring in around \$4 billion in revenues for 1991. Commercials played on television, detailing the quality of NME care, were only one component of NME's advertising campaign. Allegations went further than television ads, and claimed that NME officials were bribing police and probation officers and joining care groups like Alcoholics Anonymous to play up the importance of NME treatment.

Beginning after the original revelations by the whistleblower, Stuckey, shareholders began to file lawsuits against NME for fraud. Oddly, Stuckey died alone on his boat only days before he was scheduled to provide evidence to an inquiry by the U.S. House of Representatives in 1992. Even without Stuckey's evidence, NME was still held accountable for its actions. In 1992, 19 insurance companies sued NME for fraud and the lawsuits were settled with NME agreeing to pay more than \$214 million. In June 1994, NME reached an agreement with the U.S. government, resulting in one of the largest settlements ever. The agreement, settling charges that NME paid bribes to doctors, referral services, and

others, cost NME \$379 million, of which \$33 million was a fine for criminal activity. Later in 1998, NME was sued by the Canadian provincial government of Ontario for similar reasons and complaints.

Earlier, in an attempt to improve its image, NME changed its name to Tenet Healthcare Corporation in 1994. Following years of illegally detaining patients, bribing officials, overcharging, and acting unethically, Tenet worked to clean up its reputation. However, controversy arose once again in 2000 when a St. Louis, Missouri, woman received shock treatments for psychiatric purposes that neither she nor her son agreed to. As a result, this particular Tenet hospital was put under investigation, which lasted until a monitored program averted closure of the hospital.

In 2003, Tenet Healthcare Corporation was the second-largest healthcare corporation in the United States and, along with its subsidiaries, it operated 114 hospitals across the country and employed 116,500 people.

#### SEE ALSO

healthcare fraud; insurance fraud; unnecessary surgery; medical malpractice; whistleblowers; bribery.

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## National White-Collar Crime Center

IN 1980, LAW enforcement agencies from several states banded together to shutdown criminal operations such as heavy equipment theft, money laundering, and related white-collar criminal activities. Members of the Leviticus Project Associations realized the advantages and benefits of sharing information and pooling investigative resources. They

expanded their mission to include investigations of the oil and natural gas industries and the precious metals industry. Desiring to extend the benefits to local and state criminal justice agencies nationwide, the Leviticus Project gave birth to the National White Collar Crime Center (NW3C) in 1992.

According to their public relations, the center's mission is to "provide a nationwide support system for agencies involved in the prevention, investigation, and prosecution of economic and high-tech crimes and to support and partner with other appropriate entities in addressing homeland security initiatives, as they relate to economic and high-tech crimes." The purpose of the NW3C is to link criminal justice agencies across jurisdictional borders. The center fulfills their mission by providing support through a combination of research, training, and investigative services.

The center is developing and implementing strategies to combat a rapidly emerging and technically sophisticated body of crimes that threatens economic prosperity. It is a federally funded, non-profit corporation whose membership primarily comprises law enforcement agencies, state regulatory bodies with criminal investigative authority, and state and local prosecution offices. While NW3C has no investigative authority itself, its job is to help law enforcement agencies better understand and utilize tools to combat economic and high-tech crime.

NW3C helps law enforcement agencies with a wide variety of tools, including, training, research, programs, and conferences. The center sponsors an annual Economic Crime Summit, recognized as an important venue to spotlight global economic crime with a focus on public and private-sector investigation and prevention initiatives.

The Economic Crime Summit offers attendees an exploratory environment dedicated to education and networking. Attendees typically include fraud and high-tech crime investigators, prosecutors, certified fraud examiners, auditors, loss prevention specialists, victim services advocates, academicians interested in white collar crime, and crime prevention specialists. Starting in 2004, the annual conference will be broken down into three regional conferences.

The center offers law enforcement training courses that range from introductory to advanced levels, and are free to law enforcement agency members. Through a joint effort with the Federal Bureau

of Investigation (FBI) the center created the Internet Fraud Complaint Center (IFCC). Launched in May 2000, the IFCC is a resource established for law enforcement by law enforcement, providing a mechanism for consumers and businesses nationwide to report incidents of internet crime and other forms of fraud. In immediate support of national security, NW3C transformed IFCC into a terrorist tip portal shortly after the terrorist attacks of September 11, 2001. Over 303,000 terrorist tips were reported through the IFCC portal.

The National White Collar Crime Center is headquartered in Richmond, Virginia, and operates offices in Morgantown and Fairmount areas of West Virginia. It is a source for a wealth of information on the understanding, prevention, investigation and prosecution of economic crime, cyber crime and other high-tech crimes.

#### SEE ALSO

Better Business Bureaus; Securities and Exchange Commission; Environmental Protection Agency; prosecution; Justice, Department of.

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## NatWest Markets

NATWEST MARKETS, the largest clearing bank in the United Kingdom in the mid-1990s and a financial trading unit of National Westminster Bank of London, specialized in corporate, treasury, and investment banking. In 1997, it discovered mispricing errors in interest rate options trades that dated back to 1994. The errors were subsequently traced to a rogue trader who had elevated his paycheck through fraud and a manager who had neglected his duty to supervise.

Kyriacos Papouis was a relatively low-profile, and low-paid, London-based trader in the rate risk management division of NatWest Markets. He earned an annual salary of about £80,000. In 1996,

he left NatWest Markets just before the end of the year for a similar position at Bear, Stearns, a worldwide investment banking and securities trading and brokerage firm. By leaving, Papouis lost a projected bonus of £100,000. This bonus, a sum that surpassed Papouis's salary, came from the profits that he had supposedly generated for NatWest Markets by making trades with the firm's capital in the highly volatile interest rate options market.

Shortly after Papouis left, NatWest Markets discovered that he had lost about £50 million of the bank's money. In time, a full investigation would reveal that Papouis and his manager, Neil Dodgson, had actually sustained losses of £90 million by trading options and swaptions. (A swaption is an option on a swap, usually an interest rate swap, which is an agreement to exchange net future cash flows.)

Papouis, who traded German Deutschemark interest rate options and swaptions, had mismarked option positions in the bank's books in a concerted attempt to cover up the losses. Dodgson, who

traded Sterling (GBP) interest rate options and swaptions, also mismarked positions and failed to exercise the "due skill, care and diligence" required of him by his regulators at the Securities and Futures Authority (SFA). Poor trading and adverse market movements caused the damages, while weaknesses in operations and internal controls had permitted the crime to occur. The losses were confined to interest rate option trades at NatWest Markets. No third parties lost money.

News of the scandal became public in February 1997. The case pointed out the danger of paying traders large bonuses dependent on the profits they generate, and giving them wide discretion over the risk that they take with their employer's capital. NatWest Markets insisted that it knew nothing of the loss-making trades. Papouis was suspended from Bear, Stearns. He was subsequently expelled from the SFA and fined £50,000 plus costs of £2,500. The less culpable Dodgson received a formal reprimand, a fine of £5,000 and was ordered to



*The chaos of a bank trading room might lead to understanding how a low-level broker could hide £90 million in trading losses from the scrutiny of supervisors, as was the case at NatWest Markets.*



pay costs of £2,500. Dodgson and a number of senior managers at the bank left their positions under pressure. The SFA heavily criticized NatWest Markets for its control failings. It discovered that NatWest Markets risk management process had failed to identify a clear case of mispricing for almost a year and then failed to spot the concealment of losing positions because of "significant and widespread non-compliance with internal minimum control standards." It fined the bank £420,000 including costs.

This rogue trading scandal badly damaged the reputation of NatWest Markets and its parent, National Westminster Bank, although the losses in the capital markets were small in relation to the massive size of the bank. Investor and shareholder confidence in NatWest Markets' management was severely shaken. In June 1997, NatWest Markets lost its chief executive officer, Martin Owen, as a direct result of the episode. In July 1997, the Bank of England attempted to conclude the matter by instructing NatWest Markets to resist calls for the resignation of the rest of its senior executives.

Despite this effort, the scandal did not disappear and it ultimately forced National Westminster Bank to accept a takeover bid from the Royal Bank of Scotland in February 2000, thus eliminating one of the oldest and mightiest banks in the United Kingdom.

#### SEE ALSO

bank fraud; accounting fraud; investment trust fraud; securities fraud; United Kingdom.

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## negligence

THERE ARE FEW CONCEPTS in law more hotly contested than negligence. In popular usage, negli-

gence is defined as carelessness and is commonly contrasted with intentional or deliberate harm. In legislation and the courts, however, it has evolved over several centuries into a complex, multi-faceted concept which was subject to competing interpretations by legal theorists, politicians, and the courts.

Negligence is a key legal term in both criminal and civil law. While there have been some cases of criminal negligence in the area of white-collar and corporate crime, it is in civil law where negligence has been most utilized. Indeed, negligence is the most important component of modern tort law, the law of civil wrongs, and is frequently relied upon in cases involving personal injury or death related to product liabilities, malpractice, and employment-related activities. In the last two centuries, its development has been shaped by shifting social, political and economic beliefs among jurists, legal thinkers, and legislators.

### HISTORY OF NEGLIGENCE LAW

Prior to the 19th century, unintentional accidents causing personal harm in the English and American common-law tradition were generally governed within tort law under the principle of strict liability. (In contrasting legal systems such as continental Europe, the Canadian province of Quebec, and Puerto Rico, negligence is regarded as a form of extra-contractual obligation within the Law of Obligations). Under liability rules, plaintiffs usually only had to show that they were harmed by the defendant's conduct and were not required to demonstrate "fault." In other words, citizens were responsible for the harm their actions caused. Negligence, on the other hand, was a more complex concept that required that plaintiffs also prove "unreasonable conduct" on the part of the defendant. In theory, it was thus much easier to win a liability case than a negligence case since the burden of proof required for success was considerably lesser.

From the 1840s onward, the negligence standard had begun to replace strict liability in American tort law. Legal theorists in the second half of the century successfully attempted to systematize civil law by deriving logical and foundational principles to guide torts. They criticized what they saw as the arbitrary character of juries and their supposed predilection to favor the ordinary person against the corporate defendant. The most dominant school of American legal historians, often called

the subsidy theorists, have argued persuasively that judges and legal thinkers in the 19th century, largely sharing the interests of industrial capitalists, successfully sought to make the negligence principle central to tort law in order to encourage the free market and development of *laissez-faire* capitalism. Since negligence was usually more difficult to prove, such a legal development would be beneficial to corporations who would face a lesser risk in the event they were sued for their products or behavior as an employer. As Morton Horwitz argues, "it was the doctrine of an emerging entrepreneurial class that argued that there should be no liability for a socially desirable activity that caused injury without carelessness." Older notions of strict liability were seen by defenders of this viewpoint as anomalies to a scientific, ordered, and certain set of legal principles in line with the developing capitalist economy.

This consensus among historians has been modified recently under the impact of new studies which have shown that in local practice both liability and negligence principles were used by the courts in injury cases during the era. The harshest aspects of negligence were only implemented for a short period. Other scholars have emphasized that concepts of negligence and liability have been highly gendered processes. In the biased views of judges and legal thinkers towards women, concepts of fault and reasonableness often involved stereotypical notions of men and women, which would affect case outcomes and the development of the law. Nevertheless, a trend toward the restriction of liability and the compensatory function of tort law, in which negligence played a major part, can certainly be discerned in the dominant legal theories and court cases of the latter half of the 19th century.

It was after the tumultuous social and economic upheavals of the Civil War period that legal theorists and judges first instituted a rigorous notion of negligence. According to Horwitz, Oliver Wendell Holmes, Jr., the most influential legal theorist in late 19th century America and a long-time Supreme Court justice in the early 20th century, aimed to re-order civil law by ignoring the traditional appeal to morality and individual rights which characterized American law until the Civil War, and by constructing a more uniform, predictable, and scientific legal system. As Horwitz expresses, prevailing legal thought among Holmes and his contemporaries was rooted in the notion that "the existence of decen-

tralized political and economic institutions was the primary reason why America had managed to preserve its freedom. A self-regulating, competitive market economy presided over by a neutral, impartial and decentralized "night-watchman" state embodied the old conservative vision of why America had uniquely been able to avoid falling victim to tyranny."

## NEW ECONOMIC RATIONALITY

In the context of the emergence of large-scale industry based on competition and the profit motive, the growing power of corporations and an increasingly complex economy, there emerged new ideas about economic rationality among judges and legal thinkers that favored the relatively unimpeded growth of industry. The law itself had thus become increasingly enmeshed in the process of promoting economic growth, as judges relaxed liability law to lower the risks to industry of potential damages. Negligence would form the centerpiece of this new legal system as notions of strict liability were gradually undermined.

An 1850 Supreme Court of Massachusetts case, *Brown v. Kendall*, saw one of the first precedent-setting cases in the development of negligence. The plaintiff in this case was a man who was accidentally injured by another while both were trying to break up a fight between their dogs. The case revolved around the issue of liability and the failure to exercise ordinary care in a case in which one unintentionally injured another while engaging in a lawful act. Justice Lemuel Shaw argued that the plaintiff had to show that the defendant had either an unlawful intention or that he had acted negligently and was therefore at fault. The justices found that the defendant only had a duty to exercise "ordinary" and not "extraordinary" care. A simple case, it nevertheless originated the concept of "ordinary care" that prevailed into the 20th century.

Strict liability was overturned in two significant cases in the United States in 1873, the New Hampshire case of *Brown v. Collins* and the New York case of *Losee v. Buchanan*. These cases decided that there was no absolute liability to strangers. The former case concerned a pair of horses that were scared by a passing train and ended up damaging a light post. The driver was deemed to have used ordinary care to try to restrain the horses. The presiding judge ruled that a defendant must be proven negligent

before he is liable. As Amanda Owens observes, “tort liability was dependent on showing a lack of ordinary care and skill.” In the *Losee* case, it was maintained that damages arising from accidents involving machinery, dams, and railroads are liable only when they were a nuisance. Accidental damage was not to be held liable. A similar 1918 case in Ohio involved an action against a city for negligence due to damages suffered when a dam burst and flooded farm land. The judge decided that the city was not liable since it was only responsible for “proper duty” to its neighbor and not “impossible” obligations.

Negligence would develop in the late 19th century based on several general tenets. The first was the idea that to be held liable a defendant had to be at fault. A second key trait was that people would only be found negligent if they failed to exercise the due care of a “reasonable” person. An 1856 judicial statement cogently illustrates this notion. In *Blyth v. Birmingham Water Works*, the judge said:

The rule of negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might have been liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done.

A third trait was the notion of contributory negligence in which a defendant was not liable for damages if the plaintiffs’ actions were also partially negligent and responsible for the action. The concept of “assumption of risk” in which it was held that certain persons, even workers, were responsible for assuming some risk for dangerous situations was also developed. A final component of negligence was causation. In order for a plaintiff to win damages, it had to be shown that the defendant was the actual or proximate cause of the injury.

The notoriously dangerous railway industry was where many of these doctrines of negligence were used most extensively to acquit corporate defendants. Before the enactment of federal regulations governing the railroad in 1906, railway employers successfully used a number of defenses

based on negligence law in cases of personal injury and death in which they were defendants. Powerful railroad conglomerates could defend themselves from suits on the basis of assumption of risk since it was held that railway employees knew that the industry was dangerous when they began their employment. If the injury was the result of a fellow employee, then the railway could also argue that it was not liable. If the employee bringing the case was partially negligent, then companies could successfully use the doctrine of contributory negligence. The employee also had to prove that the employer’s negligence was the most probable cause of an injury. Using one or all of these defenses, the railway industry was incredibly successful in defending itself against law suits. Injured workers and the families of fatally injured workers were often forced to survive on family resources alone. Only in the late 19th century did a series of federal regulations begin to stipulate absolute liability in cases of railway equipment defects and safety appliances.

## THE 20TH CENTURY

By 1900, negligence had become a universal rule in tort law. Yet, just as social and political changes in late 19th-century America shaped the development of the concept of negligence, so too did an increasingly complex economy and society of the 20th-century and resultant legal changes favoring consumers lead to challenges to negligence.

In the food industry, for example, courts revived notions of strict liability due to the well-documented and pervasive illegal practices of food producers, wholesalers, and retailers. In product liability cases, a series of crucial court decisions gradually expanded the concept of liability at mid-century. By the 1960s and 1970s, an increasingly widespread belief among the population that corporations should be held strictly responsible for their products and actions led to substantially broader notions of liability. Juries began to award substantial damages for cases involving injuries caused by corporate negligence. Recently tort reforms have worked to once again restrict companies’ liabilities for its actions.

Yet negligence continues to form one of the key claims in civil law cases involving personal injuries. Modern negligence laws vary somewhat by jurisdiction, but there are common features, all of which have originally evolved from precedents set in the

19th century. All three of the following components must be shown in order for a plaintiff to win the case and receive damages:

1) The duty element refers to a person's responsibility in acting with a suitable standard of conduct to protect others from harm, that is, the concept of "reasonable person." What constitutes a "reasonable person," of course, is an ambiguous concept. Yet in *Carlson v. Chochonov* (1947), the deciding judges reckoned that while imperfect, it was justifiable: "the ideal of that person exists only in the minds of men, and exists in different forms in the minds of different men. The standard is therefore far from fixed as stable. But it is the best all-round guided that the law can devise."

2) Breaching that duty comprises the second element of a negligence case. Currently, there are objective standards of reasonable conduct which consider the behavior of a hypothetical person and a subjective standard that considers the actual defendant and if they think they acted in a reasonable way.

3) A third component of negligence claims is based on causation, that is, whether the defendant was the actual or proximate cause of the injuries sustained by the plaintiff.

Proving negligence is therefore a highly complicated and expensive task especially in an era in which corporations have proven that they will stop at no expense to defend themselves. Indeed, negligence laws may prove to be a disincentive to plaintiffs to launch cases because of the huge sums of money involved, and the elevated risk of losing the case given the difficulties in proving negligence. Corporation have experienced lawyers who specialize solely in negligence cases and are able to marshal substantial financial and legal resources to plead their cases.

The future of negligence law will depend on how future generations negotiate the degree of responsibility that corporate America should have towards consumers, employees, and the general public.

#### SEE ALSO

corporate criminal liability; medical malpractice; legal malpractice; unsafe products; defective products.

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## Nigerian 419

THE CLASSIC Nigerian fraud involves a letter, fax or e-mail to a prospective victim, promising a quick and generous return (often 20 percent or more) if he or she provides the scammer with his or her bank account numbers. The scammer says he or she needs American bank accounts to allow transfer by wire of several million dollars scammed from the Nigerian government. Once the scammer has the victim's account number, he or she cleans out the account by means of bank drafts, and the money is out of the country and gone forever. This is a \$5 billion worldwide scam which has been operated since at least 1989 under successive governments of Nigeria. It is also referred to as advance fee fraud and 419 fraud after the relevant section of the 4-1-9 Nigerian penal code that addresses fraud schemes. It has been estimated that the 419 scam is the third largest industry in Nigeria. The scheme has history going back to the 1920s when it became known as the The Spanish prisoner con.

The scam is conducted in a variety of ways, but the most prevalent involves an individual or company receiving a letter from an official of a foreign government or agency offering to transfer millions of dollars into the person's or company's bank ac-



*The advent of e-mail has created exponentially larger markets for the \$5 billion Nigerian scam business.*

count. The reason for the letter may vary from time to time, such as: My father left me \$40 million in his will, but I have to bribe government officials to get it out; the Nigerian National Petroleum Company has discovered oil, and we as officials of that company want to acquire the land, but we need a U.S. front man to purchase it first for us; we just sold an illegal shipment of crude oil in Nigeria, but we have to bribe the banker to get it out; a foreigner had died and left behind money; or the Nigerian government overpaid on some contract, and they need a front man to get it out of the country before the government discovers its error.

The scam is typically that the government overpaid on some procurement contract and the official does not want to return the money to the government. Instead, the official wants to get it out of the country. In cases where the letter recipient refuses to join the scam, oftentimes an ancillary scam is run: a Nigerian "fraud task force" official contacts the recipient and asks for assistance in cooperating with the scam so that the police can identify and apprehend the suspects.

This scam works as it causes the recipient of the letter to believe that he or she is going to scam, in turn, the Nigerian government, the Central Bank of

Nigeria, and other authorities, and obtain a high return of money on an investment, so high a return that it could only be generated from an illegal operation. Items that may indicate that the letter is a scam are as follows: there is always a sense of urgency, often a restriction is placed on the amount of time available to complete the transaction, for example 14 days; there are foreign-looking documents and often actual Nigerian officials involved, sometimes even actual Nigerian building addresses are used; the transaction must be kept confidential; a Nigerian residing in the United States or the United Kingdom acts an "intermediary" to close the transaction; often, someone claims to be of Nigerian royalty or fame. To make the scam look legitimate, the con artist sends the victim numerous documents that contain official-looking seals, stamps, and logos.

An adaptation of the Nigerian 419 fraud is called the advanced fee fraud. The underlying scam is once again an offer to achieve a large return on an investment through a fraud perpetrated upon the Nigerian government. However, in this format the victim is encouraged to pay large advance fees for various taxes, attorney fees, transaction fees, bribes, and sometimes to travel to Nigeria to facilitate the business deal.

If the victim pays the money up-front by wire-transfer or by mail, one of two things will happen: 1) the money will be simply lost and will never be seen again; or 2) and much more likely, within a couple of days contact will be made, either by phone, letter, or e-mail, telling the victim that something has gone wrong, and that to clear it up and release the funds more money will have to be sent. This latter scamming will go on literally for weeks and months, until the victim either runs out of money, or finally figures it out.

#### SEE ALSO

advance fee fraud; scams; Africa; globalization.

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## Nixon, Richard M. (1913–1994)

RICHARD MILHOUS Nixon was born in Yorba Linda, California, the son of Hannah Milhous and Francis Nixon. His mother was an Evangelical Quaker who hoped that her son would one day become a Quaker missionary. The effect of his mother's strict Quaker ideology was not strong enough to burn a lasting impression on the future president, who chose to enter politics once he returned from the Navy after World War II. Nixon would have one of the most tumultuous political careers of the 20th century, which subsequently saw him resign as president of the United States on August 9, 1974, following the Watergate Scandal. Nixon's troubles and allegations of scandals, however, were never solely confined to simply the Watergate issue.

In 1946, Nixon was elected to the House of Representatives from California. Four years later, he was elected to the Senate. During this time, Nixon was making head-waves as a major combatant against communism, especially regarding accusations of various government officials having communist ties. The anti-communist frenzy began following the war and intensified in 1950 due to the speeches of Senator Joseph McCarthy of Wisconsin, who made wild accusations that the State Department had over 200 communist supporters in its ranks. While McCarthy would become infamous for this red scare, Nixon also played a significant part.

In 1948, former State Department official Alger Hiss voluntarily appeared before the House Committee on Un-American Activities (HUAC), claiming his innocence against allegations that he had given secret documents to former American communist spy, Whittaker Chambers. Nixon was a member of HUAC, and passionately lobbied against Hiss, even accusing President Harry S. Truman's administration of being sympathetic to communism for attempting to defend Hiss. In 1948,

Nixon went before a federal grand jury and requested that Hiss be tried for espionage. Hiss had two trials, the latter in January 1950, in which he was found guilty on two charges of perjury. Nixon was instrumental in Hiss being called to trial, however, all of the information that Nixon was basing his claims on was illegally supplied to him from the Federal Bureau of Investigation (FBI). For Nixon, his anti-communist tactics did not solely result in

the Hiss trial. When he ran for Senator in 1950, his victory was aided by his accusations that his opponent, Helen Gahagan, was a communist.

In 1952, Dwight Eisenhower chose Nixon to be his vice-presidential candidate. During the election, Nixon became a source of controversy over allegations that he received illegal campaign funding from businessmen. However, Truman was able to use this controversy to gain public support by going on television and admitting that he had received a cocker spaniel, but refused to give it back because his daughters loved "Checkers." This speech not only helped Nixon to gain public support, but he was able to deflect the allegations and retain his position as Eisenhower's running mate.

After spending eight years as vice president, Nixon lost the 1960 presidential election to John F. Kennedy. In 1962, he lost the election for governor of California, stating afterward that his political career was over. Yet, in 1968, Nixon returned to the top of the Republican Party, becoming the Republican nominee and then defeating Hubert Humphrey, thus becoming the 37th president of the United States.

When Nixon ran for president in 1968, he lobbied hard for Republican supporters to help finance his election bid. Often, he mentioned how, in 1960, Kennedy had benefited from having more money behind his campaign. As a result, Nixon, like other presidents before and after, engaged in dubious affairs in order to secure campaign funding. One instance was in 1968: Nixon received over \$250,000 from 15 donors, all of whom were subsequently appointed as U.S. ambassadors during Nixon's presidency. In 1972, Nixon was the beneficiary of a massive campaign budget, raising over \$60 million. As a result, 21 business executives were convicted of illegally contributing corporation funds to Nixon's re-election bid.

The Vietnam War was the major event of Nixon's first term, and was in full force when he became president. Nixon escalated America's war effort by beginning a bombing campaign in Cambodia in 1969, where he believed Vietcong soldiers were located. Due to the mass protest that such an initiative would bring from the American public, Nixon kept this operation silent, all the while claiming he was in the process of pulling America out of the war, thus providing an early glimpse of Nixon's penchant for lying to the American public.

The Watergate Scandal, which accused Nixon of covering up a burglary of the Democratic Party offices at the Watergate office complex, effectively brought Nixon's presidency to a close. Rather than face an impeachment trial, Nixon resigned. Gerald Ford replaced him as president, and promptly decided to pardon Nixon of all charges.

One of the most fascinating aspects of Nixon's numerous, dubious, and at times, illegal actions during his political career, is that he was able to partake in such dishonest and immoral actions even though he was raised under conservative Quaker ideals. The transformation of Nixon is incredible, when it is considered that he was, as a Quaker, almost a conscientious objector to World War II. Perhaps the most fitting description of Nixon's mindset was provided by Nixon himself, when he stated that "when the president does it, that means it is not illegal," thus granting himself justification that the president was above the law.

While Nixon's presidency will forever be remembered for Watergate, and the former president

remembered as "Tricky Dick," in the years prior to his death, he was able to reinvent himself to the public. He was often sought by various presidents for his advice in foreign affairs. Regardless of his dishonest dealings as president, he was always one of the brightest minds in foreign policy. On April 22, 1994, Nixon died at age 81.

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Watergate Scandal; Ford, Gerald R.; Carter, James E.

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The era of the imperial presidency, in which Richard Nixon (left) proclaimed "I am not a crook," came to an end on August 9, 1974, when Gerald Ford (right) assumed the presidency and promptly pardoned Nixon for his alleged crimes.

## nonprofit organization fraud

A NONPROFIT ORGANIZATION is a business that has been granted exemption from federal corporate income tax because it engages in an activity that is in the public interest. A wide variety of businesses may apply for nonprofit status, including large national corporations such as arts organizations, schools, hospitals, and religious establishments, as well as smaller local businesses, such as daycare centers or small charities. Nonprofit organizations are affected by the same kinds of fraud that adversely affect the running of all businesses, such as embezzlement or fraudulent management practices. Fraud can cause substantial damage to nonprofits in two major ways: first in the loss of funding that was most likely limited to begin with, and second through the tainting of the nonprofit's reputation and credibility in the public eye. Nonprofits depend on public confidence and a sterling reputation because much of their funding is derived from governmental grants and private donations.

### NONPROFIT SECTOR

Nonprofits generally are private companies that operate in the public sector and have a social mission. A recent book on nonprofit organizations management reports that nonprofit organizations number about 1.1 million, with about 10.2 million employees. Most of these organizations are quite small, with fewer than 100 employees. This very large number of nonprofit organizations and the great variety of industries in which they are concentrated, combined with the small size and local character of many of them, mean that broad oversight and fraud prevention are extremely difficult to institute and maintain.

Despite their key role in providing social services, nonprofit organizations are usually not as transparent in terms of financial records as are government organizations or publicly traded companies. For this reason, and due to various widely publicized scandals in the 1990s and early 2000s, the nonprofit sector has a reputation, deserved or not, for being more susceptible to fraud, waste, and bad management than the for-profit sector. The role of nonprofits in the business world has become more complex as the organizations evolve to meet market demand for services. For example, the nonprofit YMCA, founded to assist socially disadvantaged

youth, has expanded into the fitness services market for all adults because it is naturally poised to take advantage of this business opportunity with already existing fitness programs and facilities. For-profit companies argue that this constitutes unfair competition, because the YMCA has the advantage of having tax-exempt status. Beyond the tax and unfair competition issues, the expansion of the mission of nonprofits also raises the spectre of fraud, as nonprofits leave behind their original altruistic motivations and compete for customers. Concern about this issue has led to calls for financial and administrative oversight for nonprofits similar to those instituted for other kinds of businesses.

Nonprofit organizations also have special operating circumstances that may make them susceptible to fraud. One possible fraud is the disguising of a truly for-profit business as a nonprofit in order to avoid paying taxes. Nonprofits also may not be subject to the rigorous controls that owners and shareholders insist on in the case of for-profit businesses; lax oversight creates an environment in which fraud can flourish undetected.

The most prevalent kind of fraud affecting nonprofits is embezzlement and other mismanagement of funds by employees, and it results for the most part from lax financial controls. Embezzling continues to be an acute problem for nonprofits; news stories appear daily about churches, schools, and other local nonprofit organizations that have had funds stolen by employees who took advantage of less than rigorous oversight of their activities.

The problem of mismanagement of funds can be found on a national level as well, despite the stronger scrutiny paid to large organizations. In 1995, the chief executive of United Way was sentenced to seven years in prison for misusing the charity's funds for personal expenses. The financial loss to United Way was estimated at \$1 million, and the lasting damage to the charity's reputation, resulting in donor hesitancy, is incalculable.

### ABUSE OF TRUST

Nonprofit charities attract a great deal of media attention when fraud is discovered, because this kind of fraud abuses the trust of unsuspecting individuals. Charity fraud takes a number of forms, including the misuse of donated funds, the deception of consumers in order to elicit donations, or illegitimate companies posing as nonprofit charities in



order to steal money intended for charitable causes. Members of the public may also not be precisely sure of the difference between a nonprofit and a for-profit business, and dishonest for-profit businesses often take advantage of this confusion and obtain contributions under false pretenses.

### “CREDIT COUNSELING”

An industry traditionally dominated by nonprofit organizations that rocked by accusations of fraud in the early 2000s is that of consumer credit counseling. In this industry, nonprofit organizations counsel debt-ridden consumers, intervening on their behalf with credit card companies and other creditors, assisting them in lowering their payments, and advising them of the appropriateness of strategies such as bankruptcy in improving their financial situation. One such company, the nonprofit AmeriDebt, has been enmeshed for years in legal proceedings, accused of abusing the public trust by only posing as a nonprofit.

AmeriDebt is accused of charging excessive fees, selling customers debt consolidation packages with little or no accompanying counseling, and then turning customers' loan payments over to a for-profit affiliate. In 1999, the District of Columbia won a \$2 million fraud suit against the company, which is also being sued by other states and investigated by the Federal Trade Commission. AmeriDebt is suspected of being more concerned with helping its sister businesses make money rather than assist consumers, an allegation that if proved would be a violation of the trust of consumers who approach nonprofits looking for assistance, as well the original intended social mission.

Nonprofit organizations often receive government funding, and it is the suspicion of the improper use of this funding that is often the engine that sets into motion the exposure of fraud. The nonprofit healthcare industry is notoriously plagued by fraud, including abuses ranging from improper billing of Medicare and Medicaid by hospitals, to the inability of local clinics to account for government payment for providing healthcare services. Other nonprofits accused of fraud have mismanaged government funds intended for the redevelopment of poor neighborhoods, or redirected public funding to an inappropriate purpose, such as support of a particular religious group or political candidate.

Finally, nonprofits may, perhaps, be more likely to have fraud engineered by employees disgruntled with their pay. Nonprofits are granted a special status because they are businesses that are not set up or meant to pursue economic wealth, meaning the employees of a nonprofit are not usually handsomely paid. Though the benefits of working at a nonprofit are perceived by the vast majority of nonprofit workers as more than financial, dishonest employees may be more susceptible to the temptation of padding a paltry nonprofit paycheck with fraud, especially when oversight is less than rigorous.

The Internal Revenue Service has a stake in overseeing nonprofit organizations, because of the benefits afforded to these organizations by their tax-exempt status. The Federal Trade Commission pursues nonprofits that defraud consumers because they are responsible for fair business practices. Newspapers such as the *Chronicle of Philanthropy* also monitor fraud in the nonprofit world. Finally, there are oversight organizations such as Guidestar, which publishes information about the operations and finances of nonprofit organizations and advises nonprofit companies on efficient and ethical business practices.

In general, it is recommended that nonprofit organizations have the same kind of internal controls that for-profit companies institute, including internal and external auditing, administrative controls, and mechanisms for ensuring that funds are used appropriately. Nonprofits are particularly vulnerable to the disastrous effect of fraud on public relations, because the discovery of fraud at nonprofits is especially badly received by the public.

Nonprofits may soon see the effects of the Corporate Fraud Accountability Act of 2002, commonly known as the Sarbanes-Oxley Act, which was passed in response to the corporate scandals of the first years of the new millennium; nonprofit organizations are, for the most part, outside the purview of this law in letter but certainly not in spirit, and may likely be expected to hew to the same new ethical standards as for-profit businesses.

### SEE ALSO

charity fraud; embezzlement; employee crimes; Medicare and Medicaid fraud; healthcare fraud.

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## North, Oliver (1943–)

ACQUITTED OF CRIMES because he was "just following orders," Oliver North first came to the attention of the American public in connection with the 1987 Iran-Contra Senate Hearings. The hearings were an effort to determine who had knowledge of and involvement in secret arms sales to Iran, and the subsequent funneling of the profits to Nicaraguan Contras (anti-communists). Congress had banned U.S. aid to the Contras. Along with other implications for careers and futures, the last 18 months of President Ronald Reagan's administration was at stake as well. If it were proved that Reagan knew of the Iran-Contra actions, the popular president would be implicated in criminal conspiracy, thus diminishing further his already flagging support in Congress and perhaps forcing his resignation or impeachment.

October 1986 found North trying to forge relations with Iranian moderates, hoping they would help win the release of American hostages in Lebanon. The White House aide reportedly authorized Middle Easterner Albert Hakim to tell the moderates that "the U.S. 'will cooperate to depose' Iraqi President Saddam Hussein and 'fight Russians in Iran.'" The decorated Marine Lieutenant Colonel North was fired in November 1986.

Although Justice Department attorney Charles Cooper and Representative Michael DeWine (R-OH) indicated they would not believe North's veracity, in early July 1987, when North's testimony was televised, polls showed he was rated favorably by 43 percent of respondents. The Vietnam War

veteran did not offer proof that Reagan knew of the affair, but did testify that he, North, sent the president five memoranda which outlined the scheme, and that North's superiors who were in direct contact with Reagan had authorized the plan. North also testified that he had seen a presidential directive, signed by Reagan, which detailed the intent to trade arms with Iran for hostages.

In February 1989, North faced a federal jury on 12 charges, including obstructing Congressional presidential investigations, destroying government documents, and receipt of illegal gratuities. North paid for a home security system with proceeds from a Swiss bank account that had been controlled by retired Air Force Major General Richard Secord, an associate in the Iran-Contra dealings. On discovery of the transaction, North tried to falsify records to show he had paid for the system from his own funds.

The most serious charges, conspiracy to defraud the government and theft, were dropped because successful prosecution depended so closely on secret documents. He was convicted of shredding and altering documents, though he said he was ordered to do so by his superiors; preparing false testimony for CIA Director William Casey and Rear Admiral John Poindexter, former national security adviser and North's immediate supervisor; and accepting an illegal gratuity for \$13,873 security fencing for his home.

Punishment could have included up to 10 years imprisonment and fines of \$750,000, but was placed at \$178,785, two years of probation, and 1,200 hours of community service. Jurors believed North's claim that he acted on orders and acquitted him of other charges. The trial did not prove what, if any, involvement there was by Reagan and Vice President George H. W. Bush. Both Reagan and Bush (who became president as the trial ended), declined to issue a pardon for the former National Security Council aide.

In July 1990 a federal appeals court suspended North's three convictions. By June 1994, North, who had regularly asked co-workers for gas and lunch money while working at the White House, was making \$20,000 for a one-hour speech, living the good life on a 194-acre estate, and running a campaign for the U.S. Senate (which he lost). He was also accused of vote-buying and making questionable solicitations for one of the nonprofit organizations he founded.

## SEE ALSO

Reagan, Ronald; Contra-Gate; Bush, George H. W.; Iran-Contra; Central America.

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## Northrop Grumman

THIS DEFENSE contractor remains trusted by the U.S. government despite a number of actions for overbilling and providing false information. For example, Northrop pleaded guilty in 1990 to 34 counts of providing false statements to the government during its work on the Air Launched Cruise Missile and Navy Harrier Jet programs. The guilty plea was the culmination of pervasive management and production problems that also dominated Northrop's work on the MX missile program.

By the time the company delivered its first Internal Measurement Unit (IMU) for the MX missile in May 1986, 203 days late, the company had been rated "marginal" in an Air Force audit. The House Armed Services Committee reported that Northrop falsely certified that parts met specifications, billed the government for its own mistakes, allowed altered worker time cards, and set up illegal shell corporations to speed parts purchasing. The shell corporations also provided an end-run around quality certification procedures. While the U.S. Air Force withheld payments, the Department of Justice pursued a criminal investigation. Of Northrop's practice of ignoring the external audits that identified problems, Representative Ron Wyden (D-

OR) told the *New York Times*, "that just strikes me as incredible incompetence."

When whistleblowers claimed a year later that Northrop defrauded the government of more than \$2 billion on Stealth bomber contracts, the federal government declined to join the suit. How much and how permanently Northrop cleaned up its operations are debatable. On the one hand, the company's public relations says the company earned a number of quality awards in 2003. On the other hand, Northrop's acquisitions the prior year generally brought with them lawsuits over defense contractor fraud, along with signs of production inefficiency.

By late 2003, the company was faced with absorbing 30 percent of a \$22 million cost overrun on the new CVN 77, a nuclear aircraft carrier built at the company's recently purchased Newport News, Virginia, shipyard. The Newport News facility's additional problems included a civil lawsuit alleging that the facility had, before Northrop acquired it, billed the government for \$72 million in tanker research and development that was actually performed for a commercial customer between 1994 and 1999. The government sought up to \$216 million in damages; the case was settled for \$60 million in early August 2003.

During the summer 2003, Northrop apparently made an aggressive effort to settle its own and its subsidiaries' problems with the government. In June, the company agreed to pay the federal government \$111 million to settle charges that TRW, which Northrop had acquired in late 2002, overcharged for a number of space-related contracts. In late August, Northrop agreed to another \$20 million in fines for selling defective aerial drones to the U.S. Navy.

The TRW prosecution, one of largest whistleblower cases ever, began when Richard Bagley, formerly chief financial officer at TRW's Redondo Beach, California, unit, sued the contractor on behalf of the federal government, an act allowed by the federal False Claims Act. The U.S. government credits whistleblower suits under this act for allowing it to recover more than \$1 billion in 2002 alone.

Whistleblowers can hope to collect up to 25 percent of the ultimate settlement. Says Bagley, who gained \$27.2 million in his action against TRW, "If I knew what I know now, I would not do it again." Bagley alleged that TRW had billed the government \$56 million for research and development that

never took place, notably a commercial satellite-based telephone system and a rocket system to launch satellites. The settlement was for a greater amount because the government can sue for treble damages.

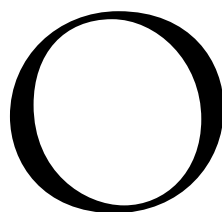
When settling these cases, Northrop's stance has been to avoid admitting guilt and to frame its acquisition policy as a successful strategy of gaining resources and access to new government contracts. In October 2003, Northrop Grumman's new chief executive, Ron Sugar, assured the *Financial Times* that the company was poised for growth without further acquisitions. Optimism was fueled by increased military spending related to terrorism and the war in Iraq. In November 2003 alone, the company announced it had gained eight major military contracts.

#### SEE ALSO

government contract fraud; government procurement fraud; whistleblowers; military-industrial complex.

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## obstruction of justice

ACCOUNTING AND insider trading scandals of recent years have, to some extent, centered around the issue of obstruction of justice. Obstruction of justice may be defined as “the crime of offering interference of any sort to the work of police, investigators, regulatory agencies, prosecutors, or other officials.” The offense is specifically defined by the United States Code as a violation of 18 U.S.C. 73, sections, 1501 through 1519.

The sections covering obstruction of justice include crimes such as: assault on a process server; obstructing examinations of financial institutions; resistance to extradition agent; influencing or injuring an officer or juror generally; influencing juror by writing; obstruction of proceedings before departments, agencies, and committees; theft or alteration of record or process; false bail; picketing or parading; obstruction of court orders; tampering with a witness, victim, or an informant; and obstruction of criminal investigations of health care offenses.

Historically, the sections of 18 U.S.C. 73 that have applied primarily to white-collar crimes have been sections 1503 and 1505. Section 1503 makes it a crime to illegally influence a grand juror, petit juror, or court officer by threats, force, or threatening letters, as well as protecting the “due administra-

tion of justice.” Section 1505 criminalizes the same behaviors and makes them applicable to proceeding of federal regulatory agencies. In *United States v. Aguilar*, the Supreme Court ruled that to be convicted of obstruction of justices, the defendant had to form specific intent to obstruct a federal judicial or grand jury proceeding.

The Sarbanes-Oxley Act of 2002, was enacted by Congress to amend and extend 18 U.S.C. 73 as a response to numerous cases of accounting fraud in which records of suspect corporations were shredded, altered, or otherwise disposed of to hide illegal behaviors, including criminal facilitation by auditors. The Sarbanes-Oxley Act amended Section 1512 to include “alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to,” as an act of obstruction of justice. The Sarbanes-Oxley Act also created Section 1519 that bars similar destruction of documents “in relation to or contemplation of ... any matter within the jurisdiction of any department or agency of the United States.

### ARTHUR ANDERSEN

Of the numerous cases of obstruction of justice brought against corporations and their officers in recent years, perhaps the most prominent has been that against the Arthur Andersen accounting firm.



*Pressing the "delete" key on accounting records during an investigation can constitute obstruction of justice.*

Arthur Andersen was an international accounting and consulting firm that, until its demise in 2002, was responsible for auditing the accounting records of scores of large corporations and organizations, such as Featherlite, Landry's Restaurants, and Enron Corporation. It was in the context of its relationship with Enron that Andersen was caught obstructing justice.

Enron was a conglomerate that was based on a classic "house of cards," in which uncollected revenues were treated as profits in ledgers, even if the revenue never was received, and losses were hidden from regulators and stockholders through elaborate partnerships with ghost corporations created by the firm's officers. The collapse of Enron's shell-game brought questions of where the checks and balances had failed. Investigators repeatedly found corporate officers to have illegally profited on the company's malfeasance. The board of directors, which was meant to supervise the officers as a fiduciary responsibility to the stockholders, were found to be nothing more than figureheads who rubber-

stamped officer's actions without question. The greatest blame, however, appeared to rest on Arthur Andersen as Enron's auditor, which did little, if anything to reign in the voodoo accounting practices at Enron, and may have indeed facilitated part of the fraudulent bookkeeping.

Once June 16, 2002, Arthur Andersen, LLP, was convicted of obstruction of justice under 18 U.S.C. 73 Section 1503. Separately, Andersen partner and lead Enron auditor David Duncan was also convicted of obstruction of justice. Duncan had directed the destruction of thousands of Enron accounting documents, electronic files, and e-mails over 17 days in 2001. These documents were destroyed in the face of an ongoing criminal investigation into Enron's accounting practices, and Arthur Andersen's participation in those fraudulent practices.

Andersen claimed it was only destroying "housekeeping" documents that were unrelated to the investigation. The destruction of documents only ended with the execution of a subpoena issued by the Securities and Exchange Commission (SEC), forcing Anderson to cooperate in the investigation by turning over all documents related to the case. Upon its conviction for obstruction on justice, Andersen was permanently barred from auditing the accounts of other corporations. In its response to the conviction, Andersen argued that the conviction was only technical in nature, and that it was wrongfully convicted for behaviors carried out by its competitors as well. In the course of a few months, over 80,000 Arthur Andersen employees worldwide lost their jobs. Andersen had fewer than 500 employees in 2004. Virtually unknown at the time was that Arthur Andersen had previously settled cases of suspected wrongdoing with regard to its audits of corporations such as Colonial Realty, Sunbeam Corporation, and Boston Market Trustee Corporation.

#### SEE ALSO

Enron Corporation; Securities and Exchange Commission; Arthur Andersen; accounting fraud.

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## occupational carcinogens

WHILE REPORTS OF occupational carcinogens were documented as early as the 17th century, it was only after World War II that a great deal of attention began to be paid to the reality of carcinogens in the workplace. By the beginning of the 21st century, it was known that industrial chemicals make up approximately one-half of all known carcinogens.

Even though most people are more likely to associate occupational carcinogens with workers who are employed in factories and mines, lethal substances may also be present in offices, laboratories, hospitals, work sites, and in many other places of business. Exposure to a cancer-causing agent does not mean that a worker will contract cancer, but it does increase risks of certain types of cancer.

In order to make the workplace as safe as possible, the Occupational Safety and Health Administration (OSHA) mandates the use of Material Safety Data Sheets (MSDS) in all areas where hazardous materials are used, and these sheets must include information about the presence of possible carcinogens. However, this information may be inaccurate, incomplete, or misinterpreted.

At best, the sheer volume of the information may be overwhelming to workers. Workers may also be unaware that occupational cancers can occur years after exposure to toxic substance occurred. For example, in asbestos-related cancers, the latency period has been identified as 30 years or more.

The study of occupational diseases can be traced as far back as the 17th century when Bernardino Ramazzini, an Italian physicist, developed a training method to help physicians diagnose work-related illnesses. Ramazzini believed that physicians should obtain information about all patients' occupations in order to identify possible causes for the symptoms the patient reported.

In the 18th century, information about occupational carcinogens became more specific. In 1775, Sir Percival Pott, a British surgeon, identified a connection between exposure to soot and cancer of the scrotum in chimney sweeps. Over the next several years, other physicians realized that workers who worked with coal tar and paraffin, or who were employed as shale oil workers or mule spinners in the textile industry, were also more likely than the general population to suffer from cancer of the scrotum.

As more physicians and researchers began to pay attention to occupational carcinogens, further evidence documented the link between pulmonary cancer and workers in metal mining. By 1895, a connection between exposure to coal tar and dyestuff and bladder cancer had been established.

In the early part of the 20th century, researchers first fully understood that cancer was not infectious but was a result of a number of variables that included heredity and environment. From this point on, the study of occupational carcinogens became common.

However, most medical schools continued to refuse to add the study of occupational carcinogens as a required course of study, leaving medical practitioners on their own as they dealt with increasing rates of work-related cancers. In 1976, Congress passed the Toxic Substances Control Act that mandated an inventory of all chemicals used in the workplace, giving physicians more data to use in diagnosing occupational cancers. This information also provided employers with details about possible carcinogens that could threaten their employees, however, many employers continued to ignore the problem.

Certain kinds of cancer have been linked to exposure to particular substances in the workplace. Lung cancer has been documented among workers who are exposed to alloys, aluminum, arsenic, asbestos, battery acids, chemicals, chloromethyl ethers, coal tars and pitches, coke, diesel emissions, nickel, radon, silica, soot, talc, textile fibers, wool fibers, and among those who work in foundries.

Skin cancers have frequently occurred in workers who come in contact with arsenic, brick-making material, coal tars, coke, mineral oil, shale oils, soot, shoe-repair materials, and wood-preserving material. The chances of contracting leukemia are thought to be increased by coming into contact with boot and shoe repair work, ethylene oxide,

paint, petroleum, radiation, rubber, and substances used in the chemical industry.

Studies on agricultural workers have also suggested possible links between exposure to various pesticides and leukemia, Hodgkin's disease, non-Hodgkin's lymphoma, multiple myeloma, and cerebral glioma. Electricians are more likely to contract leukemia and brain tumors than the general population.

A number of carcinogens have received particular attention because of the high incidences of cancer in workers who have been exposed to them. In addition to workers who have worked directly with asbestos, others who are at risk include construction workers, plumbers, shipyard workers, garage workers, and electricians. While all types of asbestos fibers are known to be associated with mesothelioma, it is thought that crocidolite is the most likely form of asbestos to produce cancer. For at least half a century, the link between exposure to beryllium and lung cancer was so well known that a condition called chronic beryllium disease has been identified. Beryllium is used in coal and oil combustors, nuclear reactors, X-ray windows, missile fuels, spacecraft, and space systems.

## CHROMIUM EXPOSURE

The first case of cancer directly linked to exposure to chromium was reported in 1890. Studies throughout the following century supported the cancer-causing properties of this metal; however, it was estimated that by 1980 between 200,000 and 390,000 workers continued to be exposed to hexavalent chromium in the workplace. Those who are most likely to be exposed to chromium include any manufacturing plant where chrome ore or chromates are used, as well as places that engage in steel and cement production, paint and pigment manufacturing, and leather tanning.

The fact that heavy exposure to diesel emissions poses a lung cancer threat to workers in certain occupations has also been well documented. In November 2000, the Public Citizen Health Research Group estimated that controlling diesel emissions could prevent between 412 and 8,261 deaths among coal miners and from 636 to 11,444 deaths among metal and nonmetal miners over a span of 45 working years. Other occupations in which workers are exposed to diesel emissions include bridge and tunnel workers, railroad workers, loading dock work-

ers, truck drivers, material handling machine operators, longshore workers, garage workers, and various transportation employees.

Lead has long been identified as a carcinogen and is known to be the leading cause of workplace-related illnesses. Workers who work with paints, battery manufacturing, construction, welding, cutting, fuels, solvents, radiator repair and firing ranges are constantly exposed to lead. Additionally, various metalworking fluids used in the manufacture of automobiles, farm equipment, aircraft, and heavy machinery have been linked to a variety of cancers. More than 1 million workers per year are exposed to silica crystalline in the workplace, and 250 of them die annually. The disease is preventable if exposure is reduced, but there is no known cure for silicosis.

According to the Surgeon General of the United States, radon is the second leading cause of lung cancer in the United States. Radon, which cannot be seen, smelled, or tasted, is present in many homes and work areas. Radon-testing kits can identify the presence of the substance so that it can be removed.

Experts who study occupational carcinogens have suggested a number of ways to reduce the risk of exposure to carcinogens in the workplace. The most effective remedy, of course, is to remove all carcinogens. When this is impossible, education, reductions in the extent of exposures, and protective clothing and equipment may reduce the risks.

## SEE ALSO

asbestos; employee safety; employee deaths; Environmental Protection Agency; Occupational Safety and Health Act.

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## occupational crime

SEE Introduction; employee crimes; embezzlement; differential association; Sutherland, Edwin H.; Geis, Gilbert.

## Occupational Safety and Health Act

IN RESPONSE TO rising concerns about worker and workplace safety, the U.S. Congress passed the Occupational Safety and Health Act of 1970 (OSHA). Enacted under the federal government's Constitutional right to regulate interstate commerce, the legislation aims to guarantee that workers across the United States have a workplace which is free from hazards like machinery dangers, constant loud noises, temperature extremes, unsanitary conditions, and toxic chemicals. In order to achieve these goals, the act authorized the creation of the Occupational Safety and Health Administration (OSHA), which was established in 1971.

OSHA covers all employers and their employees in any U.S. state or territory. An employer is "any person engaged in a business affecting commerce who has employees, but does not include the United States or any state or political subdivision of a state." As a result, many industries and businesses are covered by the employer definition, granting OSHA control over safety regulations in manufacturing, agriculture, law, medicine, charity, and education, as well as other fields. However, the law doesn't encompass all U.S. workers; those who are self-employed, farms which rely only on family members, industries which interact with and run under the authority of other federal agencies and laws, and some government employees are not covered by OSHA.

The Occupational Safety and Health Act has two main requirements: setting safety and occupa-

tional guidelines, and having regular inspections to guarantee compliance to safety and health standards. OSHA has the power to require employers to practice certain policies and methods in their workplaces and to become knowledgeable about OSHA standards. Although employers are mostly responsible for workplace safety, employees are also responsible for complying with OSHA standards.

Under the act, employers are bound under a "general duty" section of the legislation which affirms that employers must guarantee "a place of employment which is free from recognized hazards that are causing or are likely to cause death or serious physical harm to employees."

Federal OSHA regulations are standardized into four major categories: general industry, construction, maritime, and agriculture. Some standards apply to every category, but there are many that apply only to a specific category. Out of all these regulations, there are three main cross-category requirements. First, employers must give an employee access to any records that are kept about his health, as well as any additional records that document other specifics, such as toxic substance exposures. Second, the employers are required to provide the necessary equipment and protective gear to ensure a safe workplace. Third, employers that manufacture or use hazardous materials must regularly examine and test those hazardous materials for safety purposes.

OSHA regulations require that employers keep thorough records, report on OSHA compliance regularly, and post OSHA standards for employees. Any employer who has more than 10 employees, except for a few low-hazard exceptions, must keep three different types of records. These records are an OSHA Form 300 injury and illness log, an OSHA Form 301 individual incident report which provides more specific details of injuries, illnesses, or accidents from the OSHA form 300, and a national survey by the Department of Labor's Bureau of Labor Statistics on workplace safety which happens annually if a company is selected to participate by its state government.

Reports must be provided by all employers to the nearest OSHA office if there is an accident or occurrence which results in the death of any employee or the hospitalization of more than three employees. The report must be provided to the office within eight hours since an incident originally took place. As a result of the required report,



*The Occupational Safety and Health Act aims to guarantee that workers in the United States have a workplace which is free from hazards like machinery dangers, loud noises, temperature extremes, unsanitary conditions, and toxic chemicals.*

OSHA officials may examine the circumstances surrounding a death or hospitalization to determine if safety or health standards were violated.

In recent years, OSHA has pursued an initiative known as the Voluntary Protection Program (VPP), which aims to better meet the goals of the Occupational Safety and Health Act of 1970. The VPP is an attempt to extend work safety practices beyond the minimum requirements set forth in the legislation by recognizing employers and employees who have successfully incorporated health and safety into their workplace, motivating others to emulate those who are successful, and establishing a more cooperative relationship between employers and their local OSHA office.

## EMPLOYEE RIGHTS

Most importantly, employees are given significant rights which are guaranteed to them by the act and which are inviolable by employers. Employees have the right to voice their relevant concerns to their local OSHA office without having their identities revealed to their employer, to participate in OSHA inspections of their workplace, and challenge OSHA's efforts to ameliorate hazards in their work-

place. Private sector workers are protected by the legislation and may not be fired in response to filing a complaint with OSHA. In order to achieve the standards set by OSHA and detailed in the Occupational Safety and Health Act, frequent standards updates are available in the federal government's publication, the *Federal Register*. Training assistance programs are available from the more than 70 field offices, which provide workers and management with educational materials on workplace hazards, as well as the opportunity to bring in OSHA officers as consultants for the creation of a compliance program at no cost to the employer.

Violations of OSHA and Occupational Safety and Health Act standards upon inspection may result in substantial fines and, in some severe cases, may result in criminal penalties. Penalties are determined by OSHA officials based upon a standard system of assessment. Fines for repeated and willful violation of standards may reach as high as \$500,000 daily on each separate infringement for a corporation, and as high as \$250,000 for an individual. OSHA also maintains a significant appeals process for both employers and employees in order to review penalties assessed by OSHA officials for workplace violations.

SEE ALSO

whistleblowers; employee safety; workplace deaths; unions; negligence; labor crimes.

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## ***Ocean Ranger***

THE OCEAN RANGER, an oil-drilling sea rig, was built by Mitsubishi Heavy Industries of Japan and first operated in the Bering Sea off Alaska in 1976. From there it move to New Jersey, then Ireland, and in November 1980 arrived on the Grand Banks off eastern Canada. On the Grand Banks of Newfoundland, the rig was operated by ODECO Drilling of Canada, under contract to Mobil Oil of Canada. ODECO was to manage the operation of the rig and crew, whereas Mobil was responsible for the drilling program.

The *Ocean Ranger* was a massive oil rig touted as unsinkable and able to drill in areas too dangerous for other rigs. It was the pride of the offshore oil industry, the biggest rig of its day, more than 300 feet high and as long as two football fields. On February 15, 1982, the semi-submersible drilling rig capsized and sank in the Grand Banks, 170 miles east of St. John's. Poor training, inadequate safety equipment, design flaws, and 120-mile-an-hour winds sealed the fate of the 84 crew members. All of them died.

A Royal Commission was founded to determine the cause of the tragedy. The findings revealed a history of negligence regarding safety. ODECO failed to provide qualified marine personnel, had not replaced the lifeboats, and did not have a valid Certificate of Inspection at the time of the sinking. ODECO also neglected to provide any sort of survival suits for the crew. Mobil failed to ensure the crew had been through proper training as well as to instruct the captain of his duties.

The commission found neglect in safety, hiring, training of the crew and management, engineering design, and overall construction of the rig caused the *Ocean Ranger* to plunge to its destruction. A more strict inspection and regulation of the vessel should have been undertaken by the United States and Canadian governments in order to prevent the disaster. There should have been training provided on a regular basis for the operation of the rig, and evacuation in case of emergency. Many of the workers did not know the safety rules and escape procedure. Evacuations drills should have been mandatory. Families of the lost crewmembers sued the companies that owned and operated the *Ocean Ranger*. The companies were forced to pay out millions of dollars in lawsuits.

The oil company was held liable because its workers weren't trained for emergency procedures and didn't do any emergency drills. Experts found the *Ocean Ranger* could have survived the storm flooding if those in charge had understood how the ballast system worked. The two men working in the ballast room had never been tested for their competency. The senior operator had only reached the halfway point in his training but was promoted to the senior operator. The *Ocean Ranger* did not have enough safety equipment on board for the number of workers, just one example among other forms of gross negligence.

Although there were civil liabilities, no criminal charges were brought; this is often the case when death and injury is a product of violence from an employer's negligence, rather than that of a single individual outside the workplace.

SEE ALSO

employee safety; workplace deaths; Canada; negligence.

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## offshore bank accounts

OFFSHORE BANK ACCOUNTS are often associated with the darker side of major finance. Their high degree of confidentiality offers an ideal opportunity for tax evaders, arms and drug traffickers, terrorists, and corrupt politicians. Although most offshore banks offer a variety of legal services, many of these institutions have been tarnished as corrupt. These institutions are magnets for people wishing to profit from money laundering, fraud, corruption and tax evasion. The appeal is bank secrecy, which offers animosity to its clients. Offshore banking is a blue chip multi-billion dollar industry and involves international banks, major investment firms, and accounting firms. The special private banking services they provide allow big savings for big-money clients, who take advantage of the bank's discretion. Many of these clients fall in the \$50 million to \$100 million dollar range of assets, which allows for full advantage of overseas laws.

Offshore banking also offers an attraction for investors who want to diversify their portfolios and reduce their vulnerability in the face of domestic disturbances. They offer commercial services, such as loans, and foreign currency trades, investment and tax consulting; however, they often charge much higher interest on accounts than conventional banks. There are approximately 55 offshore zones, the largest being Switzerland. Five major clusters for offshore finance are the Caribbean, Europe, the Middle East, Southeast Asia, and the South Pacific.

The amount of money that moves about in offshore banking is staggering. According to information gathered by Lynch & Gemini Consulting, as of 2000, one-third of the money of the wealthiest individuals may now be held in offshore accounts. The amount of money being moved in and out of offshore accounts could be as high as \$6 trillion. Experts think it is possible that one half of the world's money flows through these accounts. The International Monetary Fund (IMF) claims that up to \$1.5 trillion in illicit money is laundered through offshore accounts each year, with an additional \$5 billion in laundered drug money.

The United States and Europe both face the continuing and substantial loss of tax revenue due to hidden funds and many countries are now asking that reforms be made and enforced. A growing number of offshore banks specifically target professional people who can handle a minimum deposit

of \$80,000 or more. The IRS estimates that at least \$100 billion in funds obtained through legal sources are placed in offshore accounts for the purpose of tax evasion.

Great secrecy is maintained concerning offshore accounts. Privacy is strictly upheld and account information cannot be divulged. Its non-regulated system of banking is allowed to interact with standard banks, which only serves to further their popularity. With the advent of electronic communications, monies can now be immediately transferred, making attempts to track the funds increasingly difficult. Funds can be transferred an infinite amount of times, and checkpoint areas can be rendered useless when transactions take place in person. By changing jurisdictions, it is easy to cause confusion over tax and fund amount issues.

### 99 PERCENT FAILURE

OXFAM International estimates a \$50 billion loss to third world countries because of trade taking place through shell accounts. Attempts by Interpol, international police cooperation, to seize money from laundering rackets have yielded only about \$3 billion over the last 20 years. Unfortunately, that amount is equivalent to the amount of money laundered in a typical three-day period. U.S. Treasury officials claim their efforts to combat money laundering has over a 99 percent failure rate.

More attention is being given to the subject of offshore banking due to the high profile discoveries, such as the account used by Osama bin Laden, who moved money to the Al Taqwa bank, which was registered in the Bahamas and operated from Switzerland. Enron Corporation set up 780 shell companies in the Grand Cayman islands, as well as an additional 80 companies in the Turk & Caicos Islands. This allowed them to manage insider trading, hide financial records, deceive investors and creditors, and avoid paying U.S. income taxes. The discoveries of these two cases have caused both politicians and the public to pay closer attention to the issue. Although the United States has been slow to call for radical reforms, the European public has called for an end to offshore banking.

In the Caribbean, Grenada's senate passed legislation to strengthen offshore regulations. It has closed more than 30 banks and has asked that two recently passed bills be signed by their governor and made into law. The Exchange of Information

Act is aimed at reducing opportunities for illegal acts such as tax evasion, money laundering, drug trafficking, and terrorism. The Offshore Banking Act would strengthen the power of the government to supervise, investigate, and administer licenses.

Nauru, the world's smallest republic and an island in the Pacific, was once considered the second largest provider of offshore banking, until it announced an end to its offshore operations. This action has taken place in an attempt to combat global criminal activities, money laundering, and terrorism. In the face of global threats, many changes can be expected in offshore banking practices and regulations, as their impact on world economy and prosperity becomes more evident.

#### SEE ALSO

offshore entities; Caribbean Islands; bank fraud; tax evasion; Switzerland; Luxembourg.

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## offshore entities

OVER THE PAST 30 years, the number of offshore zones offering financial services proliferated. The growth of the offshore financial sector is routinely attributed to increased financial regulations, and higher taxes imposed on account holders in industrial countries. To avoid the scrutiny of regulators and lower tax burdens, Western firms and wealthy individuals relocated significant portions of their financial activities to offshore markets, which promise enhanced secrecy and client confidentiality with financial transactions conducted through offshore entities.

By some estimates, more than half of the global financial transactions pass through offshore centers, and nearly 20 percent of total private wealth is invested in offshore financial centers. Offshore finan-

cial centers also routinely offer an array of tax and regulatory incentives for non-resident investors. For individuals with significant assets, a number of jurisdictions, such as the Bahamas, Bermuda, the Cayman Islands, the Cook Islands, Gibraltar, and the Isle of Man, permit the establishment of offshore asset protection trusts. Individuals establish an asset protection trust by transferring ownership of financial assets to a trust that has only foreign trustees. The trustees, who have no formal office, manage the trust property through the offshore zones.

Asset protection trusts changes the character of the assets held by the debtor from one that can be easily seized and sold, to an asset that the creditor cannot legally seize and sell. When creditors attempt to seize assets, even if they discover the offshore trust, a foreign trustee, who is most often uncooperative during the investigation, holds the funds.

For example, courts in the United States have no jurisdiction over foreign trustees, and therefore are unable to provide any relief to creditors. The actual geographic distance between the creditor and the trustee also poses significant barriers to creditors, and law enforcement and regulatory agencies. Asset protection trust corporations routinely advertise their services (a means to avoid frivolous litigation, and seizures of funds by government agencies) for an initial cost of less than \$1,000 for minimal trust protection, or more than \$30,000 for complex trust protection schemes.

Individuals can also establish an offshore corporation, an entity recognized by law as a separate "person" with limited liability. Offshore corporations may issue shares, raise capital, make contracts, and maintain checking and saving accounts. Like the asset protection trusts, offshore corporations provide limited information to law enforcement and regulatory agencies. For example, under Panamanian law, the names of corporate officers, directors or shareholders are confidential, and not filed in the public registry.

Another financial instrument offered by offshore financial zones are bearer share certificates, which do not indicate the name of the owner of the certificate. Bearer shares facilitate the transfer of assets by permitting the transfer of ownership simply by the transferring of the certificate to another individual. Some offshore centers mandate that corporations issue only registered share certificates, that have the name of the owner on the document. But

corporate records, which record the registered owner of the certificate, are an internal document available only to directors, officers, and shareholders. No public registry of shareholders is maintained. offshore zones also routinely offer customers the services of shelf companies, corporations that have been created to meet a client's immediate needs. The shelf companies only require a registered local agent who receives legal documents on behalf of the owner of the company.

Over the past two decades, the international community instituted a number of measures to reduce the comparative advantages of the offshore zones, and force tax havens to comply with international regulatory and accounting practices. For example, a number of global financial centers, such as London, England, and Frankfurt, Germany, have instituted massive deregulation, which reduced tax rates, and diminished the comparative advantages held by the offshore financial sector.

Additionally, new oversight bodies were created to monitor the offshore zones. For example, The Financial Stability Forum (FSF), which includes representatives of the International Monetary Fund (IMF), and regulatory bodies such as the Basel Committee on Banking Supervision, were created to examine offshore centers and to assess the quality of their respective regulatory environments offshore. The FSF submits a survey that requires banking, insurance, and securities supervisors to evaluate the level of resources devoted to supervision and international cooperation, and the degree of cooperation by individual offshore centers. Based on the survey results, the FSF identifies regulatory and enforcement weaknesses that facilitate the laundering of illicit capital in offshore zones.

## REGULATORY RESPONSE

The responses of individual jurisdictions to these initiatives have varied widely. Some opponents of the international initiatives to mandate better oversight of offshore zones have urged resistance through formal legal action. However, most offshore zones responded positively, by strengthening their regulatory infrastructures for supervising offshore financial vehicles and service providers, and enacting anti-money laundering laws.

A number of these jurisdictions have explicitly committed to addressing FSF concerns and are to improve the transparency of their tax regimes and

increase the effective exchange of criminal and civil tax information. Though numerous states have agreed to more closely monitor offshore zones, several countries in the Caribbean and South Pacific are boosting their limited economies with offshore sectors.

For example, in late 2000, domestic and international regulators expressed considerable concern after Vanuatu, a Southern Pacific island chain, passed a law that permits proprietors to establish web-based e-commerce sites, and conduct business from Vanuatu without the need to form an offshore corporation. The new legislation permits the establishment of a "cyber-suite," a Vanuatu-based website from which business can be conducted without revealing the identity of company directors and shareholders. Moreover, the owner of the cyber-suite does not have to maintain a physical presence in Vanuatu, such as a registered office.

Another unsettling trend is the concerted effort by countries throughout the Caribbean to become global centers for internet gaming, a \$10 billion industry. Dominica, a country routinely criticized by international monitoring bodies for failing to institute anti-money laundering norms, established a regulatory framework that permits offshore operations of internet gaming through high-speed fiber-optic and satellite facilities. The gaming license permits the establishment of traditional forms of gaming over the internet, including slot machines, video poker, and gambling on a wide variety of sporting events, such as basketball, soccer, and auto racing. Criminal organizations are attracted to internet gaming because companies are exempt from income tax, withholding tax, sales tax, and foreign exchange controls.

While a number of regulatory controls have been instituted by offshore zones, domestic law enforcement and regulatory agencies that oversee offshore jurisdictions must also assure Western regulators that financial institutions are complying with international anti-money laundering standards. But more work must be done. This could be accomplished by removing secrecy provisions, increasing the number of unscheduled on-site inspections, and sanctioning financial institutions that fail to submit suspicious activities reports with fines and closures. This would allow offshore zones to adopt international anti-money laundering norms, and reduce the opprobrium routinely proffered by Western regulatory and law enforcement agencies.

## SEE ALSO

offshore banking; bank fraud; money laundering; drug trafficking; reform and regulation; Caribbean Islands; Central America.

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## oil crimes

OTHER THAN the food, water, shelter, and clothing necessary for survival, oil may be the single most valued substance in contemporary international society. Because the entire world has become so dependent on oil, this valuable resource has influenced population shifts in certain regions, elected or toppled the heads of nations, ignited and fueled wars, and affected foreign policy decisions. Oil crimes evolve from the fact that this coveted resource, in some form or another, is a negotiable resource that induces greed, ambition, and corruption. Oil crimes may be as simple as an individual at a gas pump driving away without paying, or they may be so complex that they involve millions of dollars and the citizens of several countries. Oil crimes may also be crimes against nature and the environment that range from a ship leaking oil to spills that discharge millions of barrels into the ocean and onto beaches.

### AMERICAN OIL

After oil was discovered in 1859 in Titusville, Pennsylvania, it became a major element in the Industrial Revolution in the United States. In the early days of oil development, the American oil industry was controlled by only a few companies that created large trusts designed to cut out competition and retain as many profits as possible by controlling the

entire process of petroleum or oil production and transportation.

These trusts were controlled by oil barons such as John D. Rockefeller of the Standard Oil Company, who ruthlessly squelched competition. The large oil companies manipulated prices in such a way that they received rebates from railroads while independent refineries were charged twice the going rate. When competitors or independents balked at the ruthless tactics of the oil barons, they were taken over or forced out of business. In the 1870s, the situation became so crucial that it led to the Oil War of 1872, which resulted in parades and mass meetings during which Rockefeller's effigy was burned. A Congressional investigating committee uncovered what it saw as "one of the most gigantic and dangerous conspiracies ever conceived." The oil barons claimed that the trusts benefited the consumers, but critics charged that rigged prices and wages threatened the American economy. The U.S. government agreed that monopolies restricted trade; and in 1911, the U.S. Supreme Court ordered Standard Oil to divest itself of its various subsidiaries.

During the 1930s and 1940s, the U.S. government began to work with privately owned oil corporations in the Middle East to produce sufficient oil to help swing the balance of power toward the Allies in World War II. By the end of the war, the economies of these oil-producing countries had changed forever. The three major players in the Middle East during this period were ARAMCO, an international oil cartel; the U.S. government, which promoted the Middle Eastern colonialism that sprang from the war years; and the government of Saudi Arabia, the largest oil producer in the Middle East and the motivating force in establishing oil prices and policies. In the more developed regions of the world, oil soon replaced coal as the major source of energy. Between 1945 and 1960, consumption of oil and gas doubled because oil was used to provide power for several essential industries such as steel, cement, metalworking, and glass. At the same time, an increase in the numbers of cars, trucks, and other motorized vehicles added to demands for more gasoline at cheaper prices.

In the 1970s, the United States was caught up in a major oil crisis that caused the prices of gas to soar and led to long lines at service stations in some parts of the country. With only a 30-day supply of oil left, the U.S. government restricted the amount

of gasoline available to service stations and ordered oil refineries to turn their petroleum stocks into heating oil. Speed limits were lowered around the country to further conserve gasoline. The crisis was not an actual shortage in the production of oil, but an intentional oil embargo by the oil cartel (Organization of Petroleum Exporting Countries or OPEC) of the Middle East that had belatedly realized that it could become a major player on the global economic scene by controlling access to oil.

During the Arab-Israeli Yom Kippur War of 1973, the reigning oil powers in the Middle East had decided that they could use oil to force the West to honor Palestinian claims over those of Israel. By the time the embargo ended, oil prices had risen to more than five times the original consumer price. By the end of the 20th century, oil would become a major factor in funding international terrorist activities. Oil, fueled by politics and religion, would continue to heighten tensions in the area for generations to come.

## OIL AND POLITICS

Just before World War II, Standard Oil of New Jersey was accused of being so obsessed with profits that it supplied Germany with oil products that helped to create the monstrous Nazi war machine, even though the company was well aware of Hitler's activities in Europe. Standard defended its action by claiming that it was just retribution for the theft of German secrets over the previous 15 years that had helped the Allies wage war against Germany.

During Richard Nixon's successful 1968 presidential campaign, several Texas oil companies were fined for illegally contributing thousands of dollars to Nixon's campaign with the hope that he would protect the domestic oil market. Four years later, contributions to Nixon's 1972 campaign created a scandal of major proportions.

In 1974, the Senate Watergate Investigating Committee began to probe illegal contributions made to Nixon's Committee to Re-Elect the President (CREEP) before the new Federal Election Campaign Act restricted large contributions to political campaigns. The trail led to the executives of several major American oil companies. Ashland Petroleum Corporation, the Gulf Oil Corporation, and Phillips Petroleum Corporation had each contributed \$100,000 to the Nixon campaign at the request of CREEP representatives.

When the Watergate scandal became public, the money was returned. The three companies paid maximum fines of \$5,000, and the executives who had initiated the contributions within each company were fined \$1,000 each. The investigation also revealed that Gulf Oil had contributed to the unsuccessful presidential campaigns of Democratic candidates Wilbur D. Mills of Arkansas and Henry M. Jackson of Washington. W. W. Keller of Phillips Petroleum was believed to have coordinated the oil industry contributions, and he admitted that Phillips had also contributed to various House and Senate campaigns in 1970 and 1972, totaling some \$60,000.

The oil industry's involvement in the Nixon campaign surfaced again when the Watergate Committee learned that Robert H. Allen, a Texas oilman who headed Gulf Resources and Chemical Corporation, had contributed the \$100,000, routed through a Mexican bank, that had been deposited in the account of Bernard L. Barker. When Barker was arrested, he carried \$89,000 of the Allen contribution with him. Barker pled guilty to conspiracy, burglary, and wiretapping on charges related to the Watergate break-in. It was estimated that at least 413 directors, senior officials, and stockholders of 170 oil and gas companies had contributed a total of \$4.98 million to the Nixon re-election campaign, providing 10 percent of Nixon's total donations. As a result, Nixon was unable to put pressure on domestic oil companies during the energy crisis.

The oil industry also played a part in the scandal of George H. W. Bush's administration that became known as Iraq-Gate (since Watergate, most scandals somehow got the appendage "gate.") In 1989, representatives of several oil companies, along with representatives from General Motors, Westinghouse, and Xerox, accompanied members of Kissinger Associates, headed by former Secretary of State Henry Kissinger, to Baghdad, Iraq, to meet with Saddam Hussein. While the visit was geared toward finding ways that the United States could help Iraq defeat Iran, a secondary purpose was to increase the American oil supply. After the Bush administration made improved relations with Iraq a priority, the United States began to import more than 1 million barrels of Iraqi oil a day.

Christopher Dorgoul, an executive of BNL in Atlanta, pleaded guilty (but later recanted) to 60 felonies connected with his role in supplying Saddam Hussein with billions of dollars that were used



to build ballistic and chemical weapons plants. This encouraged an environment in which mass killings and widespread political instability flourished, while Hussain tried to cover up his actions. Ultimately, Dorgoul pled guilty to three felonies and was sentenced to 37 months in jail.

## INTERNATIONAL CRIME

A major scandal erupted in France in mid-2003 when it was discovered that the Elf-Aquitaine Oil Company operated an unofficial slush fund for the French government. French investigators learned that Elf routinely paid for everything from bribes to foreign governments to campaign contributions for the two major parties in France. L  k Floch-Prigent, Elf's chief executive, received a home that cost 9 million francs (about \$2.25 million) and an Elf-funded 4.5-million-franc (about \$1.15 million) divorce settlement. Floch-Prigent told investigators that President Francois Mitterand had ordered him to pay off his ex-wife so she would not blow the whistle on Elf's activities.

In October 2003, Mikhail Khorkovsky, the wealthiest man in Russia and the owner of Yukos Oil, was arrested by masked agents who boarded his plane at a Siberian airport. Khorkovsky was charged with tax evasion, fraud, forgery, embezzlement, and failing to abide by a court order. Khorkovsky is a strong supporter of the opposition party in Russia. His arrest was followed by the resignation of Russian President Vladimir V. Putin's chief of staff, Alexander S. Voloshin, who opposed the arrest. Voloshin was reportedly afraid that Khorkovsky's arrest could lead to capital flight and general economic instability.

In May 2003, a scandal erupted in Khazakhstan that involved American James H. Geffen, a counselor to President Nursultan Nazarbayev. Geffen was accused of channeling \$60 million in oil commissions and bonuses into the president's account and another \$17 million into the account of Nurlan Balgimbayev, the head of a state-owned oil company. After the scandal broke, Swiss banking officials opened an investigation into the scandal and froze a dozen accounts in the names of Geffen, Nazarbayev, and Balgimbayev.

Geffen was charged with 39 counts of money laundering and eight violations of the Foreign Corrupt Practices Act, which prevents Americans from paying bribes to obtain contracts in foreign coun-

tries. Geffen could face up to 20 years in jail and \$84 million in penalties and fines. Investigators were also researching the activities of Mobil Oil, which paid bonuses to Geffen to ensure access to several oil fields in Khazakhstan. Two other Mobil executives were charged with failing to pay taxes on money received in kickbacks.

In March 2003, several churches in the Sudan charged Talisman Energy Company, a Canadian oil firm, with implicitly approving a campaign of genocide conducted by government officials against non-Muslim residents, that included kidnapping, rape, murder, and confiscation of land. The plaintiffs said that more than 2 million people had been killed since the genocide began.

The Nigerian Economic and Financial Crimes Commission announced in July 2003 that it was investigating two Americans who were suspected of being involved in the Halliburton scandal, in which American oil officials in Nigeria paid \$2.4 million to a Nigerian firm to avoid paying taxes on its Nigerian subsidiary. The tax scheme was discovered by the Securities and Exchange Commission when Halliburton claimed a \$5 million tax payment to Nigeria that never appeared in its books. The Bush administration denied that Vice President Dick Cheney, who had headed Halliburton at the time, was involved in the scandal.

## OIL THEFT

A number of countries around the world are forced to devote a good deal of attention to problems that arise over oil theft. In Great Britain, for example, authorities estimate that robberies at service stations ranging from credit card fraud to major robberies resulted in approximately a \$35million loss to the oil industry in 1992. Thailand has such an enormous problem with smuggled oil that it began an intensive campaign in 2002 aimed at controlling the problem. The Thai government offered a bounty of 30 percent of the value of the property seized to encourage informers to notify the government about the activities of smugglers. The campaign quickly led to the arrest of three major smuggling rings.

In February 2002, Romanian authorities arrested five employees of the state-owned PETROM oil company in connection with the theft of more than 20 tons of petroleum fuel that was mixed with other fluids and sold in diesel fuel. The crackdown



*An oil refinery is just one step in the oil production process that can include numerous varieties of white-collar crime.*

on stolen oil led Thai legislators to pass a new law that mandates an 18-year sentence for the theft of oil from pipelines. Russian authorities estimate that more than 10 million tons of oil are stolen in that country every year. In 2002, the Interior Ministry reported that around 3,300 oil-related crimes had occurred in Russia, resulting in losses of more than 270 million rubles (about \$10 million).

It is believed that organized crime is behind a large number of the oil-related crimes. In April 2003, Chinese authorities cracked down on a smuggling ring in Beijing, the capital, which involved 80 tons of oil products and eight boats. In one raid the month before, border police seized 25 yachts owned by the smugglers along with various oil products, tires, and computer equipment.

## OIL SCAMS

In 1998, the U.S. Post Office investigated a mail scam that came to be known as The Nigerian Oil Letter, in which an individual who claimed to be a Nigerian prince and the head of a petroleum company offered recipients a 30 percent share of a \$28.6 million pot if the recipient provided bank account information so the money could be deposited. Another scam in 1998 was identified as the first case of computer-aided gasoline fraud in the United States. Four employees of Mepco Oil in Los Angeles, California, aided by a pump technician, manipulated oil pumps at several service stations to pump a lower amount of gasoline than the pump registered. These scam artists managed to hoodwink station owners and inspectors before they were discovered. The oil company agreed to pay \$640,000 in penalties, investigative costs, and inspector training. Between 1980 and 1981 Marc Rich and Pincus Green engaged in \$105 million in fraudulent oil trades before they escaped to Switzerland. President Bill Clinton included Rich as one of his eleventh-hour pardons upon leaving office.

In Scotland, the McGovern crime family developed a scheme in which they sold gasoline at prices below any competitor. They used the money to generate cash to hide their illegal activities, including drug trafficking and money laundering at the local carwash. In South Korea, the chief executive of S-Oil, Kim Sun-dong, was sentenced to three years in jail in October 2002, after he was convicted of manipulating oil shares and accounting fraud. He and his partner, Yoo Ho-ki, who was quickly released after being sentenced to 10 months in jail, manipulated their accounts to show a \$153 million profit for S-Oil, claiming that it was the way things were done in Korea.

## OIL SPILLS

The damage inflicted on the environment by oil spills is extensive, and the effects can linger for years after a oil spill occurs. Because oil is transported thousands of miles through pipelines and in an ever-increasing number of tankers, the potential for accidents has accelerated in recent years. In March 1967, the 118,185-ton *Torrey Canyon* spilled 3.5 million gallons of Kuwaiti crude oil into the English Channel, polluting English and eventually, French beaches and presenting new pollution problems.

The ship's master was reportedly trying to beat the tide when the boat ran aground on the Seven Stones. When the ship hit the rocks, it broke open. Under British law, the owner or master of a ship that discharges oil into international waters may be prosecuted.

Because the *Torrey Canyon* spill was the world's first major spill, no one was sure what to do. The British attempted to mitigate the damage by flushing the oil spill with two million gallons of detergent, which was toxic to some marine life in the area. Ten days after the spill, the British government ordered aerial bombing of the tanker to burn off oil left on board. By the time the oil reached France, experts had devised a more eco-friendly method of using 3,000 tons of chalk to bind to the oil and force it downward into the water.

On March 24, 1989, the 211,469-ton Exxon *Valdez* entered Prince William Sound in the Gulf of Alaska. The captain of the ship was inebriated and asleep in his quarters while an unlicensed third mate steered the ship. When the vessel ran aground on Bligh Reef, it released 11 million gallons of crude oil into Prince William Sound. Immediately, a thick layer of black ooze covered the stones and rocks along the coast. It was estimated that seven killer whales died, along with 360 harbor seals, from 3,500 to 5,500 sea otters, 250,000 birds, from 1,500 to 2,000 pigeon guillemots, and 250 bald eagles. Traces of the oil spill will continue to be present for several generations to come. Exxon was required to pay \$125 million to cover direct and unforeseen environmental damages. The jury also awarded plaintiffs \$5 billion in punitive damages.

In March 2002, a Danish ship, the *D/S Progress* entered Baltimore Harbor while spewing oil from a leak in its hull. The captain had notified the shipping company, which told him not to report the leak to the U.S. Coast Guard. However, two crewmembers who believed that their lives were threatened by the leaking oil slipped Coast Guard inspectors a note explaining the situation. Under the Act to Prevent Pollution from Ships, the crewmen received \$125,000 of the \$250,000 fine levied against the shipping company.

While most oil spills are caused by accidents or human error, a new kind of environmental threat occurs when oil wells are set on fire, as they were during the Persian Gulf War in 1991. As Iraqi troops evacuated Kuwait before multinational forces moved in, they intentionally set fire to 650 of

Kuwait's 935 oil wells and spread oil slicks throughout the country. Approximately 525 million metric tons of crude oil were burned before the fires were extinguished. The Iraqis also opened pipelines at sea terminals to spread further havoc. The troops that had come to free Kuwait were attempting to manage the environmental chaos left by departing Iraqi troops. Environmentalists and meteorologists worried that the smoke could contribute to a change in the climate of Kuwait and Saudi Arabia, and some experts believed that the smoke affected Bangladesh and China by contributing to unusually heavy precipitation. Birds, fish, mammals, and invertebrates were killed by the oil. Fortunately, the extent of the damage was mitigated by heavier-than-normal monsoon rains.

#### OTHER ENVIRONMENTAL HAZARDS

Oil developers are required by law in many countries to protect the environment as much as possible. Before the rise of environmentalism in the 1970s, however, protecting the environment was not generally addressed by oil developers. For example, when the Blue Creek oil field was developed in West Virginia in 1968, residents were appalled at the amount of devastation that followed. One state legislator called it rape because oil developers destroyed fields, forests, and farmland and polluted much of the state's water supply.

In October 2003, a case involving ChevronTexaco's pollution of the Ecuadorian rain forest went to trial after eight years of wrangling over jurisdiction. The company was sued by 30,000 residents of the rain forest, who claimed that in the 1980s, the oil company refused to line its waste pits despite the potential hazards to residents and the environment.

The chief evidence in the case was a letter written in 1980 in which the company expressly rejected the possibility of relining or filling the waste pits because it would cost \$4,197,958. In addition to the damage caused by the unlined waste pits, records revealed a long history of oil leaks in the pipelines that transport oil from Ecuador to the world market, with more than 297,000 barrels of oil leaking from 1972 to 1989.

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Standard Oil; air pollution; water pollution; Arab nations; Middle East; Exxon *Valdez*; corruption; Rockefeller, John D.

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## oligopoly

AN OLIGOPOLY IS A MARKET dominated by a small number of participants who are able to collectively exert control over supply and market prices. Usually if four or fewer firms control at least 50 percent of a given market in one product or service (for example, light bulbs, canned soup, razor blades, temporary workers) an oligopoly is said to exist.

Oligopolies are related to white-collar crime and deviance largely by attempts to limit competi-

tion or expand their markets. Oligopolies have developed a number of practices which serve to limit entry into the industry by new firms, to avoid price competition, and manipulate demand.

It is very costly to enter an industry dominated by a few well-known names. Large firms often purchase the successful smaller firms via mergers and acquisitions. Larger firms sometimes rely on their established relationships with customers or suppliers to limit the activities of smaller firms. Because market control by a few giant firms make it very difficult for smaller businesses to market new products or production processes, pricing and market share remain in the hands of larger corporations. This tends to keep the law of supply and demand from functioning and, consequently, prices remain artificially high. One study estimated that if oligopolies could be broken up, the cost of living for consumers would be reduced by 25 percent.

In many industries, one firm (usually the largest) becomes the established price leader. This firm is usually the first to raise prices in the face of rising costs. The others then also increase prices. This situation is informal and non-conspiratorial because any arrangement to raise prices among industry firms would constitute price-fixing, which is against the antitrust laws.

This practice serves to reward rich stockholders and corporate executives with rising stock prices, thereby funneling even more money to the richest segments of wealth holders and income earners. It also serves to make poorer those who do not own large blocks of stock—especially the middle class and the poor.

A large or diverse firm that can stand temporary losses by lowering its prices below its production costs until it either forces competitors out of business or becomes price leader, is said to conduct predatory pricing. Then it can re-raise prices. This is illegal, but very hard to prove in court. Collusion to fix prices is also used, even though it is illegal. Price-fixing is a major form of white-collar criminal activity that is very costly to the public. One study estimated that price-fixing may cost the American public as much as \$78 billion per year.

Oligopolistic firms often create demand for their products via advertising. This sometimes results in the production of images instead of true product differences. What advertising leads to is brand recognition on the part of consumers. Advertising serves to limit competition because smaller

firms can not afford commercials on large television networks. One advertising study estimated that 90 percent of all the commercials on prime time network television are sponsored by the largest 500 corporations in the United States. Advertising agencies make use of demographic research and psychological appeals. They use focus groups with sociological traits similar to their target markets and analyze these customers.

In discriminatory pricing, firms can increase profits by separating markets. Airlines do it all the time. They sell business customers high-priced seats since their demand is constant. Lower priced seats are sold to tourists, who tend to be bargain hunters and will fly only at lower price. Restrictions are developed to keep business customers from purchasing tickets at the tourist price.

In certain oligopolistic industries, some forms of criminal activity tend to become standard practice. One study of the criminal activity of the 582 largest publicly owned corporations between 1974 and 1976 found two-thirds of the criminal violations took place within just three industries: automobiles, petrochemicals (oil), and pharmaceuticals.

Study after study has demonstrated that oligopolistic corporations are the largest contributors to political campaigns in America. This has been accomplished by the formation of Political Action Committees (PACs) and so-called soft money contributions, which function to get around established campaign financing laws. Sometimes corporate lobbyists actually help politicians write legislation that they favor, or work in the political campaigns of the politicians they sponsor. Other times, members of large corporations actually run for office themselves, or accept posts as cabinet officers or undersecretaries in the executive branch of the federal government. Many corporations have also established foundations and associations that take positions on public issues.

All these practices function to keep political power in America entrenched within large corporations and inhibit reform of oligopoly practices.

#### SEE ALSO

campaign finance; price fixing; price discrimination; predatory practices; automobiles; pharmaceutical industry; oil crimes.

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## Oraflex

ORAFLEX, A PAINKILLER for arthritis patients sold by Indianapolis, Indiana-based pharmaceutical giant Eli Lilly, is believed to have killed 49 people in the United States after the company illegally concealed evidence of several hundred deaths caused by the medication in overseas markets. Oraflex, known as Opren outside of the United States, went on the overseas market in 1980. From January 1981 to June 1982, Lilly received reports about problems with the medication in the United Kingdom and other countries where the drug was sold. The reports said that four people died from liver failure after taking Oraflex, three people suffered kidney or liver problems, and three developed jaundice. Lilly put Oraflex on the U.S. market in May 1982. On August 5, 1982, Britain banned the drug and Lilly voluntarily withdrew Oraflex from the U.S. and international markets.

Federal law requires companies to inform the Food and Drug Administration (FDA) of any adverse reactions from new drugs but Lilly did not do so. In 1985, Lilly pleaded guilty to 25 criminal counts for failing to inform federal officials of four deaths and six illnesses that occurred after patients took Oraflex. However, FDA officials declared that Oraflex had been linked to 49 deaths in the U.S. and several hundred abroad. The pharmaceutical company received the maximum penalty of \$25,000, or \$1,000 for each count. All of the counts were misdemeanors. Federal authorities did not charge the company with intentional deception. William Shedden, former vice president and chief medical officer of Lilly Research Laboratories, pleaded no contest to 15 criminal counts related to the drug and was fined \$15,000.

In Britain, Lilly became the target of a lawsuit launched by 1,300 Britons who claimed that they

had become ill, or that relatives died from taking Oraflex. In 1988, 1,000 of these plaintiffs settled with Lilly for an estimated £6 million (\$10.9 million) to £7 million (\$12.8 million). The company continued to deny that it intentionally withheld medically significant information.

#### SEE ALSO

Eli Lilly & Company; pharmaceutical industry; health-care fraud; Food and Drug Administration.

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## organized crime

THE ITALIAN MAFIA and its American counterpart has been the most high-profile organized crime genre for much of the 20th century. Increasingly, the term *Mafia* can be applied to any group of nefarious underground criminals, whether of Russian, Indian, Mexican, Jewish, or Italian heritage, who engage in organized crime. Organized crime, in turn, can be broadly defined as two or more persons conspiring together on a continuing and secretive basis to participate in profit-oriented illegal activities. Like other criminal organizations, the Mafia (also known in America as *Cosa Nostra*) is involved in a myriad of unsavory activities.

In addition to common organized criminal conspiracies, such as extortion, illegal gambling, smuggling, loan-sharking, and drug trafficking, the American mafia has been involved in what can be classified as white collar crimes, such as business and labor racketeering, insurance fraud, embezzlement, bankruptcy fraud, government (tax) fraud, and stock market manipulation.

#### ORIGINS

There has long been a debate about the origins of the Mafia, although there appears to be a consensus that it evolved from a patriarchic social network

that has existed in Sicily, Italy, for centuries. Secret groups made up of ethnic Italians began to emerge in North America during the latter part of the 19th century with the massive Italian diaspora, or emigration. The debate circles around whether a secret criminal conspiracy, methods, and infrastructure was exported from Italy to North America around this time or conversely, if the origins of the North American *Cosa Nostra* can more accurately be traced to the cultural environment indigenous to the United States, and to a lesser extent, Canada.

As a reflection of its secretive nature, the Mafia, has been defined, conceptualized, and characterized in any number of different ways. Some have argued that the Mafia is a worldwide criminal organization headquartered in Sicily, with branch plant families located throughout the world, including North America.

Under this characterization, the Mafia is an inter-connected global criminal conspiracy, with the same historical origins, over-lapping memberships, and corresponding codes and membership rites of passage. Others have argued that the American *Cosa Nostra* is separate and distinct from the Sicilian Mafia in its origins, development, and operations.

#### OUR THING

Some scholars stress that the word *mafia* should not be used as a noun to describe a particular secret society or criminal conspiracy. Instead, it represents a philosophy that is based in historical Sicilian cultural traditions. Finally, there are those who reduce this debate to a simple question of semantics: whether one calls it the mafia, the Honored Society, the Yakuza, the Russian Mafia, La Cosa Nostra, the Syndicate, Our Thing, or any other name, it involves a group of men, mostly (but not exclusively) of a distinct ethnic heritage, that is involved in ongoing criminal conspiracies.

Historical evidence suggests that beginning in late 19th-century America, groups and networks made up of ethnic Italians, in particular Sicilians, increasingly were involved in organized criminal conspiracies. The growth of Italian organized crime in America was the result of a potent mix of sociological customs and traditions associated with the Sicilian Mafia. These combined with the foreign American urban environment (complete with a tradition of lawlessness, poverty, and discrimination)

into which immigrants were acculturated. Italians as well as English, Irish, and Jewish immigrants were all major players in the formative years of organized crime in North America.

The earliest criminal activities undertaken by the Italian groups centered on the extortion of money from Italian immigrants and businesses. In addition, they increasingly offered goods and services, both legal and illegal, to satisfy the demands and vices of Italian communities in urban America. They ran lotteries and other games of chance and operated houses of prostitution. They were loan-sharks to gamblers and also served as bankers and moneylenders to those who could not borrow anywhere else, often charging usurious interest rates. They captured a monopoly on artichokes, olive oil, wine grapes, and other necessities of Italian life and extracted a price for permitting their distribution. They helped future Italian immigrants make their way to North America, often at a fee that placed the new arrival and their sponsors in a state of eternal debt to the Mafia benefactor.

## PROHIBITION

It was the criminalization of liquor in 1920 that truly launched Italian-American criminal groups, and organized crime in general, into a more sophisticated and profitable epoch. The widespread demand for outlawed liquor in the United States led to the ongoing development of well-organized groups and networks of distillers and bootleggers. Prohibition expanded and organized the underworld, transforming the existing marauding gangs of smugglers and extortionists into sophisticated and extremely profitable criminal enterprises.

The organization of Italian-American criminals was also heightened in the early 1930s through the formal establishment of Cosa Nostra families in New York and other American cities, as well as the founding of the Commission, a ruling clique and arbitrator, made up of the heads of all the major Cosa Nostra families, that mapped out territories among the participating families and established rules and regulations, a code of honor, and dispute settlement mechanisms. While individuals and groups of any ethnic background could be part of or come before the Commission, binding decisions could only be made by Sicilian members.

The period between the repeal of Prohibition in 1934 and the outbreak of World War II (1939) was

one of expansion and consolidation of the Cosa Nostra. According to organized-crime researcher Robert C. Stewart (1994) there are a number of reasons why Italian-American crime groups emerged and prospered in the underworld during Prohibition and the decades to come.

First, they had a scope, purpose, and membership that transcended that of any single conspiratorial episode. Second, members shared a deep sub-cultural bond that was reinforced by a Mafia code that emphasized loyalty and secrecy. Third, they emphasized a networking structure that enabled members to collaborate on joint business ventures with a wide variety of criminal groups and networks, including ties with criminal organizations in Italy. Fourth, Cosa Nostra members continuously exploited opportunities to make money in a systematic, expansive, protracted, and diversified manner. They were capitalist entrepreneurs in the true sense, and they fashioned their criminal operations to be highly synergistic in nature. For example, gambling operations fed their loan-sharking business, which in turn generated the indebted business person (who then forfeits a businesses) or the debtor warehouse worker (who pinpoints a valuable item in storage to be stolen).

Since they first appeared on the North American landscape, Mafia groups, members, and associates adroitly and successfully infiltrated a wide range of legitimate businesses to further their legal and illegal commercial activities, including companies involved in the production of alcoholic spirits, commercial transportation, entertainment, importing and exporting, hotels, restaurants, bars, automobile dealerships, construction, real estate, waste disposal, food distribution, garment manufacturing, and legalized gaming, to name just a few.

## JUST BUSINESS

The Mafia also discovered that the techniques it used in the underworld, that is, extortion, violence, intimidation, and corruption could also be used in the legitimate commercial world with success. Mark H. Moore suggested in *Major Issues in Organized Crime* (1987) that the organized crime group should be viewed as a business firm pursuing profit with a portfolio that encompasses illicit as well as licit enterprises: "They coolly calculate how best to make money without worrying about whether a planned enterprise is illegal."

Annelise G. Anderson, in *The Business of Organized Crime* (1979), provides six reasons for organized criminal involvement in legitimate businesses.

*Revenue and wages:* For persons involved in organized crime, profit provides motivation; not all members of organized crime are able to make sufficient income from illicit activities. Anthony Russo, an underboss in Long Branch, New Jersey, once complained to Sam De Cavalcante that the *amici nostri* (friends of ours, meaning members of the Mafia) could not support themselves financially. In addition to legitimate revenue, cash-based companies provide a source of “skimming,” which provide a source of tax-free income.

*Diversification:* Another reason that criminal entrepreneurs invest in legitimate businesses is for the diversification of capital; spreading investments into a number of different ventures. Diversification may entail moving into legitimate industries and introducing unfair and openly illegal tactics. A legitimate business provides the organized crime figure with income security that may not be available exclusively through illegal activities.

*Transfer:* Illegitimate enterprises are often difficult to legally transfer to dependents (particularly if they are female). Investing in legitimate enterprises such as a business or real estate ensures that an estate can be legally inherited.

*Services:* A criminal entrepreneur operating a legitimate business is in a position to act as a patron for a person in need of legitimate employment, such as associates on probation or parole.

*Front:* A legitimate business can provide a front or a base of operations for a host of illegal activities, including loan-sharking, gambling, and drug trafficking, to name a few.

*Taxes:* A legitimate business can provide a tax cover, thereby reducing the risk of being charged with income-tax evasion. Funds from an illegitimate enterprise can be mixed with those from the legitimate business, particularly if it is a cash-based business.

To this list, we can add a seventh reason: money laundering. While companies are established by criminal entrepreneurs for a number of reasons, arguably the greatest single reason for organized crime’s present infiltration into the private sector is to launder the proceeds of their illicit activities. Especially attractive to money launderers are businesses that customarily handle a high volume of cash transactions, such as retail stores, restaurants,

bars, currency exchange dealers, gas stations, etc. because the cash proceeds of illegal activities can be deposited into bank accounts as legitimate revenue (either alone or commingled with revenue actually produced from the business). Due to the immense profits generated by their illegal activities, in particular drug trafficking, which became a major source of revenue for the Mafia beginning in the 1950s, there was an increased reliance on money laundering through legitimate businesses.

## CASINOS

It was during the late 1940s that the groups began to parlay their significant experience in illegal gambling, bookmaking, and underground casinos to legal gaming by financing and controlling some of the original casinos in Las Vegas, Nevada. Benjamin (Bugsy) Siegel, who had long been associated with some of the leading figures of the New York Mafia families (including Charles Luciano, Meyer Lansky, and Frank Costello) was sent to California to oversee the West Coast operations of the Cosa Nostra. This included overseeing the lucrative racing wire service, and increasing the mob’s influence in Hollywood’s labor unions. Siegel also scouted out Las Vegas as the possible site for a gambling casino and hotel that would be funded by the New York families. Soon after his beloved Flamingo Hotel opened, Siegel was killed by the very individuals who bankrolled his vision. After his death, Mafia families from New York and other parts of the country continued to invest in and ultimately controlled many of the casinos in Las Vegas, helping to situate the city as the gambling capital of North America.

## UNIONS AND RACKETEERING

Mafia members also had a long-standing relationship with labor unions, influencing and even controlling certain union locals by relying on two tactical weapons: corruption (of union, business, and government officials) and the capacity to intimidate by threats of violence. The labor racketeering activities of the Mafia included extorting businesses by threatening union problems, raiding union pension funds, negotiating “sweetheart contracts” between unions and management, and providing union membership and fictitious jobs to Mafia members and associates. Labor racketeering provided a foray for the mafia to extort legitimate busi-



nesses and, in some cases, entire industries through intimidation, control over labor unions, or ties with corrupt government officials.

According to Howard Abadinsky in *Organized Crime* (2003) New York City's Fulton Fish Market, the source of much of New York's seafood, represents a classic saga in the ability of the mafia to control a legitimate industry through labor and business racketeering. Though the market was established in 1833, the organized crime connection began in the early 1920s, when Joseph (Socks) Lanza, a member of New York's Genovese crime family, organized workers into Local 359 of the United Seafood Worker's Union. As head of the local, Lanza extorted money from every dealer in the market and, along with his brother Nunzio, determined which businesses could operate in the market. Through his leadership of the union and influence over the supply of labor, Lanza asserted control over fishing boats.

He also controlled the Fulton Market's Watchmen's Protective Association, and any market vendor who failed to have a Lanza watchman look after his vehicles usually had slashed tires the next day. Lanza was convicted of racketeering in 1938, and in 1943, he was convicted of extorting local Teamster union officials. Convictions and imprisonment notwithstanding, Lanza continued to control the Fulton Market until his death in 1968, when the responsibility was passed to another Genovese family member.

Despite the fact that the market operated on city property, government controls remained absent for decades, creating a lawless atmosphere in which rules of operation evolved through violence and intimidation. In 1988, as a result of a civil action brought by the U.S. Department of Justice, U.S. Attorney Rudolph Giuliani convinced a federal judge that the market was dominated by organized crime and an outside administrator was appointed to monitor the market and rid it of illegal activities. Reforms established by the city have reduced, if not eliminated, the influence of organized crime. Ironically, this is seen as a mixed blessing by the market's wholesale dealers, who complain of rigid rules and increased overhead costs.

## FRAUD

Beginning in the 1950s, the Mafia became increasingly involved in fraud, including government tax-

ation fraud, insurance fraud, bankruptcy fraud, and stock market manipulation. Government taxation fraud primarily entailed the smuggling and distribution of high-taxed goods, such as liquor, cigarettes, and motor fuel. Contraband liquor and cigarettes were obtained from truck hijackings, and by illegally transporting cigarettes and liquor from low-tax states for sale in high-tax states.

Mafia groups in the United States and Canada are also known to cooperate with Russian crime groups in fuel-bootlegging scams designed to defraud the government of federal excise taxes (FET) levied on oil sales. In one type of FET fraud, numerous dummy companies are established to purchase home heating (diesel) oil, which is tax-free. The diesel oil is then sold through the fake companies as diesel fuel, which is subject to federal taxes. The taxes are collected by the criminals, but never submitted to the government, explains the Federal Bureau of Investigation (1995). Insurance fraud began with mafia members taking over businesses (often from recalcitrant debtors) and then committing arson to collect the insurance money. Government reports as far back as the early 1970s documented the involvement of mafia groups in bankruptcy fraud. Members would purchase or take over a business, and then buy merchandise on as large a scale as possible through the use of credit. The merchandise is turned into cash, much of which is skimmed. The business eventually is forced into bankruptcy by its creditors, which, of course, was the original intent of the scam.

For example, a principal in a major Italian-Canadian drug-trafficking organization in Canada regularly bankrupted his businesses. Once a business went bankrupt, he would arrange for a new company to be formed to buy out the assets of the failed business at a reduced cost. Bankruptcy was also used to void intentionally accrued debt. "Flipping" companies through fraudulent bankruptcies also facilitates money laundering; pumping illicit funds through a procession of businesses helps create an obfuscating layering process that is essential to legitimizing the proceeds of crime.

The initial foray of the mafia into the stock market began with the rudimentary theft of stock certificates and the use of intimidation to extort money and insider information from brokers. However, the securities market is also subject to more sophisticated manipulation and fraud by mafia groups. In a 1996 report, *BusinessWeek* alleged that

some families had established a network of stock promoters, securities dealers, and “boiler rooms” that sold stocks nationwide through high-pressure sales tactics. The article estimated that four mafia families, as well as Russian criminal entrepreneurs, directly owned or controlled, through front men, two dozen brokerage firms. Citing court documents, the article stated that Philip Abramo, a ranking member in the New Jersey-based DeCavalcante family, controlled at least four brokerage firms through front men, and exerted influence upon still more firms. Other securities dealers and traders were believed to pay extortion money or “tribute” to the mafia as just another cost of doing business.

### PUMP AND DUMP

In 2000, law enforcement officials in New York uncovered a coordinated effort between a mafia group and Russian criminals to steal millions from brokerage firms using threats, bribes, pension-fund raids, and “pump and dump” stock manipulations. The indictments allege the defendants profited by secretly controlling blocks of shares and pushing them onto ordinary investors through high-pressure “boiler room” sales calls. The price was kept artificially high by refusing to let anyone sell. Mafia enforcers would be stationed at the office’s trading window to ensure none of the brokers could sell on behalf of their clients. After the stock value rose, mafia members cashed in by selling their secretly held shares, before the inflated value of the stocks plummeted.

In court testimony, former members of the New Jersey DeCavalcante crime family provided a glimpse into organized crime activity on Wall Street, especially during the internet boom of the 1990s. Vincent (Vinnie Ocean) Palermo, a self-confessed murderer and former acting boss of the family, told the court that Philip Abramo was “always bragging about how much money he made on Wall Street, saying he was the best in the business.” Victor DiChiara, another former associate of the DeCavalcante family, qualified as a broker in the early 1990s and worked for several Wall Street firms. DiChiara testified in court that he began his career as a broker at Hanover Sterling, which he stated was owned by two Genovese associates, Roy Ageloff and Bob Cataggio. Hanover was a “boiler-room operation” designed to “pump and dump” shares. DiChiara alleges that in 1994, Abramo asked him

for a list of house stocks, the shares Hanover controlled. DiChiara claims Abramo told him he had approached Hanover’s bosses and warned them of the drop in price, which could be averted if they paid him \$500,000. The offer was rebuffed. When the shares started falling, Abramo again offered to help, this time for \$5 million. Hanover refused and true to his predictions, the value of these stocks crashed, causing Hanover clients to lose millions, and which eventually led Hanover to its bankruptcy.

Abramo’s market manipulation activities were not confined to the United States. In Vancouver, Canada, stockbroker Jean Claude Hauchecorne, who worked at Pacific International Securities Inc. until mid-1999, was accosted by a client he knew as Louis Metzger (but was Abramo), whom he recognized from a photo in the 1996 *BusinessWeek* article. With Abramo was Philip Gurian, another mafia-connected figure who placed dozens of orders with Hauchecorne to buy and sell U.S. stocks, many of which had been identified by *BusinessWeek* as mob-manipulated stocks. They demanded that Hauchecorne return \$1.75 million he had transferred to Switzerland on the instructions of another mafia operative, Eric Wynn, who had had a falling out with Abramo and Gurian. Otherwise, they would kill him.

The Ontario Securities Commission, the largest securities regulator in Canada, speculated that organized crime is active in the junior markets across Canada, through money laundering, manipulating share prices, and conducting insider trades. In the 1970s, William Obront, a loan shark and the financial brains behind Montreal’s once-powerful Cotroni Mafia family, was charged with over 400 counts of fraudulently manipulating stock shares over a 15-year period.

### INFILTRATION

In addition to the direct negative impact that extortion or fraud may have on businesses, the involvement of organized crime in the legitimate economy has enormous repercussions for individual companies and entire industries. Crime groups that have infiltrated businesses or labor unions often strive for monopolistic control over a particular industry, which they will pursue through fraud, corruption, labor racketeering, intimidation, and violence. Well-organized fraud and money laundering can distort the financial markets leading to market instability

and deflate investor confidence. Illegal entrepreneurs may be able to use their criminal assets to assist their legal enterprises and disadvantage their non-criminal counterparts. Businesses run by organized crime groups have access to capital (produced by illegal activities) that is not available to legitimate business people, which can undercut competitors with below-cost prices.

#### SEE ALSO

gambling and lotteries; prostitution; drug trafficking; securities fraud; scams; Cuba; Capone, Alphonse.

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## outside directors

QUITE SIMPLY, outside directors are those members of a company's board of directors without executive responsibilities, and who often face information asymmetry about the company. They are usually appointed to the board of directors for their contribution to the expansion of the enterprise's strategy and to provide important knowledge not otherwise available to management. Outside directors, like inside directors, have two main roles: to ensure that the company delivers returns to shareholders (the performance function) and to ensure it acts in accordance with laws and regulations (the accountability function).

However, given the distance of their day-to-day operations, outside directors have more of a role to play in terms of the accountability function than in terms of the performance function. Outside directors are beneficial to an enterprise provided the company does not employ them in any other manner, including consulting contracts.

Outside directors provide access to valuable resources and information, but several corporate governance analysts insist on tighter rules of independence including a restriction on the number of directorships a single individual can hold, investor participation in the selection and appointment of outsiders, and mandated meetings with significant shareholders.

In the early 2000s, firms made significant changes to their programs, plans, and policies for members of their boards of directors. A struggle continues between the growing need for qualified persons and the reluctance by some candidates to join boards. This reluctance can be attributed to increased time requirements, and potential reputation and financial risk.

The result is increased competition for qualified board members, especially standing chief executive officers and candidates with substantial financial experience. This, in turn, impacts outside-director

compensation. If outside directors are to provide meaningful protection for investors, they must be in a position to challenge the executive management and draw attention to dubious practices, even in apparently successful companies.

While independence is, above all, concerned with the integrity of the individual in question, it is not unreasonable to suggest that financial ties, whether personal, business, political or philanthropic, threaten the independence of outside directors and therefore their motivation to actively challenge management. But, rather than simply meeting some checklist of independence criteria, analysts say it is imperative that outsiders are able, in practice not just in theory, to express views to the board that are different from those of the chief executive officer. They must also be confident that, provided this is done in a considered way, they will not suffer reprisals.

Several proposals intend to set limits on how much money can be exchanged between the company for which an individual is a director, and another company for which she is an executive or employee. For example, the New York Stock Exchange (NYSE) proposed that if a director received fees in excess of \$100,000 a year in direct payment from a company, then she should be presumed not to be independent until five years after such fees stop being received. Some proposals extend the scope of such fees to include nonemployment based compensation, such as executive consultancy work.

The collapse of Enron Corporation triggered corporate governance analysts to question whether outside directors should be accountable for, or simply be more aware of, a company's complex finances. In the United States, there are specific rules that aim to ensure that outside directors are independent, but in the light of financial high-profile events in the early 2000s, it is questionable whether these rules have had any real impact on the effectiveness of audit committees.

Of course, the level of diligence required in an increasingly demanding corporate environment may mean that outside directors need to devote more time to their role as ethical accountability partners, who also oversee efficiency of organizations' productivity.

#### SEE ALSO

board of directors; interlocking directorates.

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## Owens Corning

ALTHOUGH OWENS Corning, organized in 1938, sold less than 1 percent of all asbestos products, by 2000 it had been driven to bankruptcy by the settlement of 243,000 asbestos-related claims, with more claims pending. Owens-Illinois manufactured and sold Kaylo, a high-temperature calcium silicate pipe insulation which contained asbestos, from the late 1940s through the early 1950s. At that time Owens Corning agreed to sell the asbestos product. In the late 1950s, Owens Corning purchased Kaylo assets and began to manufacture and sell the product.

Following indications of potential health problems, Owens Corning, Johns-Manville, and other asbestos products manufacturers put warning labels on their products, and in 1972 Owens Corning removed asbestos from Kaylo, although it did continue to make that product with only calcium silicate. In 1980, the Occupational Safety and Health Administration (OSHA) began to require warnings on products that contained asbestos and to regulate their use.

In 1978, two shipyard workers who had developed asbestosis, an asbestos-related lung disease, filed a class-action lawsuit on behalf of 5,000 other workers against Toledo, Ohio-based Owens Corning and 14 other asbestos producers. The suit claimed these companies knew the hazardous nature of the mineral as early as 1938 but did not do enough to protect people working with it.

Huge settlements were awarded in asbestos-related suits, including an \$18 million award for punitive damages to each of three New York victims. The amount was said to have been settled on be-

cause the number 18 symbolizes life in Hebrew. There was an additional \$1.2 million in compensatory damages awarded in this case. Johns-Manville, who had an estimated 40-50 percent share of U.S. asbestos liability, filed for bankruptcy in 1982.

Over the next few years, companies with asbestos-related liabilities and their insurance carriers formed and disbanded organizations in attempts to control fallout from the issue. More of these manufacturers filed bankruptcy, and Owens Corning took its second major reserve (\$1.1 billion) on its financial balance sheet with which to pay litigants in 1996.

Also in 1996, Owens Corning filed a Racketeer Influenced and Corrupt Organizations (RICO) suit against three testing laboratories, claiming the Mississippi, Louisiana, and Alabama companies manipulated medical tests so they would give false indications of asbestos injury. At the time the suit was filed, Owens Corning stated they had paid \$2.6 billion for asbestos claims. This included some of the 40,000 claims which were from allegedly false lab reports.

In July 1997, Owens Corning acquired Fibreboard, another manufacturer of asbestos products. They filed suit against tobacco companies four months later, claiming that asbestos workers who smoked had a much higher rate of asbestos injury than those who did not, and asked that the tobacco companies be required to pay part of the settlements. This claim was dismissed by a Mississippi

Circuit court in 2001. By the middle of 2000, Owens Corning had resolved over 243,000 asbestos claims and had another 27,000 pending. With these financial draws on the company and a weakening economy, Owens Corning's long-term debt grew to over \$2 billion in 2000. The 62-year-old company filed for Chapter 11 bankruptcy on October 5, 2000.

#### SEE ALSO

asbestos; Occupational Safety and Health Act; Johns-Manville; employee safety.

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# P

## patent infringement

INNOVATION IS the motivating force in most businesses. Without new inventions and ideas, companies would be unable to keep up with competition and would stagnate. This has been true since America was made up of 13 separate colonies, and the United States of America was only a dream for visionaries. Benjamin Franklin, one of the Founding Fathers of the United States, who played a role in forming both the Declaration of Independence in 1776 and the United States Constitution in 1787, is often credited with discovering electricity.

In truth, Franklin invented the lightening rod that led to discoveries about how electricity works. He also invented bifocals, the odometer, and the Franklin stove. Inventors such as Franklin have an intellectual property right to own their inventions, and this right was considered so important that patent protection was included in the U.S. Constitution (Article 1, Section 8). Patent protection allows individuals and businesses to control who uses their inventions and provides them with recognition and monetary benefits. When others violate those rights, patent infringement occurs.

The U.S. Patent Office was created to administer all laws relating to federal patents and to advise the president and the Department of Commerce on all matters related to protecting patents and copy-

rights, and to offer advice on dealing with the ways that intellectual property is related to trade both domestically and internationally. In 1988, the name of the patenting agency was changed to the U.S. Patent and Trademark Office (PTO) to reflect the growing importance of protecting trademarks as intellectual property.

The PTO issues three types of patents: plant patents, design patents, and utility patents. Plant patents are given for new plants that have been asexually reproduced. Design patents are assigned for the design of a product, like a sofa or a beverage dispenser. Most patents approved by the Patent and Trademark Office are utility patents that protect inventions such as machines, processes, and improvements to existing machines and processes.

In addition to approving and renewing patents, the PTO maintains existing records of all federal and international patents to assist applicants who always bear the responsibility of searching for existing or similar patents before a patent application is filed. Once a patent application is approved, the owner of the patent has the right to exclude others from making, using, or selling the patented invention as long as the patent is valid.

The Patent and Trademark Office has no authority to hear cases of patent infringement because that authority is given to various courts of jurisdiction. Patent infringement occurs when another

party makes use of a patented product or invention by making, using, or selling the invention without the patent owner's permission and without paying any licensing fees that may be required. Patent owners have a legal right to sue in order to protect their inventions. However, patent infringement is much harder to prove than infringement of trademarks or copyrights, which are more concrete. Patent infringement cases may be expensive, and they may take years to wind their way through the courts. In 2002, for example, less than 3,000 patent infringement cases were filed.

In order to win a patent infringement lawsuit, a plaintiff needs to show first of all that the alleged infringer willfully and intentionally violated the patent owner's rights. The burden of proof is always on the owner of the patent to show that patent infringement did indeed occur. The plaintiff must produce evidence to back up her claim to the patent, as well as documenting any damage that resulted from the infringement. Patent infringement evidence may be circumstantial, but it must be either substantially credible or persuasive.

### NO USE REQUIREMENT

Federal courts have accepted infringement of patents in cases where the defendant has not actually used the patented invention, but has been prepared to use it in a way that violates the owner's patent. Plaintiffs have not always been required to show that the defendant profited monetarily from the infringement. For instance, in 1984 in *Trans-World Manufacturing Corporation v. Al Nyman and Sons*, a federal district court held that infringement occurred when Nyman and Sons provided a display rack free of charge to its customers even though Trans-World owned the patent on the display rack and Nyman and Sons had no right to use it.

Recoveries for patent infringement are limited to the six years preceding the filing of the complaint against the alleged violator of the patent. Remedies for patent infringement include injunctions, damages, and attorney's fees. Injunctions are issued to prevent an alleged violator from continuing to use the patented product or process. Compensatory damage is normally based on lost profits, established royalties, and reasonable royalties. The reasonable royalty measure was designed to help judges determine adequate reimbursement for losses incurred through patent infringement in

cases where the patent owner is not able to document specific losses. Traditionally, the judge attempts to determine what the patent owner's profits would have been if a valid license at a "reasonable rate" had been issued for the time the infringer illegally used the product or process. Additionally, a violator may be forced to pay prejudgment interest and increased damages. The Patent Act of 1982 provided a means of settling patent disputes through binding arbitration if both parties agree to do so in writing.

### AWARDS AND JUDGMENTS

Judgments in patent infringement cases have frequently resulted in enormous awards for plaintiffs, partly because courts are able to award treble damages in situations where willful infringement occurs. Such a case occurred in 1982 when Johns-Manville was found to have literally copied a fluorescent light fixture from the company brochure of LAM, a small competitor. The judgment against Johns-Manville included triple damages for lost profits, triple damages for reduced profit, and triple damages for projected lost profits, plus prejudgment interest and attorneys' fees for a total award of \$1,639,824.21. Other large awards in recent years have included a \$56 million award won by Pfizer Pharmaceuticals from International Rectifier which infringed on Pfizer's patent rights to a particular antibiotic. Pfizer also recovered \$44 million from American Hospital Supply which infringed on a blood oxygenator patent.

Other awards were even higher. Procter and Gamble was allotted \$125 million when Nabisco illegally used a patented cookie recipe. Smith Industries won almost double that amount, which included a \$70 million interest payment, from Hughes Tool's infringement of a rock drive bit. Kodak was forced to pay its rival Polaroid \$873 million for infringing on a patent for an instant camera design.

Lawyers for defendants in patent infringement cases have the responsibility to raise certain questions to prove to the court that their clients' actions did not infringe on the patent rights of others. A common practice is for defense lawyers to question the validity of the original patent. It is also possible for the alleged infringer to prove that her use of the invention in question was not covered by the owner's patent. Language is particularly important

in determining infringement of patent rights. It may be possible for a defendant to show that the language of the original patent did not prevent it from being used in a certain way. Patent infringement cases follow the rule of common law in the United States, drawing on a body of existing decisions or precedents for guidance. While the federal government has the right to use a patented invention without express permission of the patent owner, the government is required to compensate the owner for use of the invention. If the federal government violates a patent, the plaintiff has the option of asking the Court of Claims to award damages. Cases of patent infringement at the federal level may be appealed all the way to the U.S. Supreme Court.

### INFRINGEMENT LAWSUITS

Because many of the most impressive technological advances of the last several decades have been involved with computers, a number of prominent patent infringement lawsuits have dealt with these technologies. For example, In 2003, VIA sued Media-Tek for patent infringement, claiming that the company's products used on computers throughout the country infringed on VIA's patent for the process that allowed Media-Tek products to increase the bandwidth of high-speed optical storage devices. A case filed by Multi-Format, a company composed of two inventors located in New Jersey, claimed that Multi-Format has a patent on the entire process of playing DVDs, and the company threatened to sue all DVD retailers, studios, replicators, and manufacturers if they did not obtain licenses for various DVD processes. The technology media and the music industry responded to the threat by suggesting that if the suit were successful, it could raise the price of DVDs beyond the reach of many consumers. In some instances, patent infringement cases are settled without disclosing the terms of the agreement. For example, in June 2003, Silicon Image won an undisclosed amount from Genesis Microchip for violating its patents on the Digital Visual Interface (DVI) and the High-Definition Multimedia Interface (HDMI).

Microsoft may have been sued more than any other company in the computer industry, and both judges and juries have enjoyed attacking the creator of such high-profile products as Windows, Internet Explorer, Microsoft Network, and Microsoft Office. Hundreds of cases have been filed against Mi-

crosoft since the introduction of Windows 95 changed the computer industry in August 1995. In the midst of Microsoft's troubles with the Department of Justice over an antitrust lawsuit, Bill Gates and company were also sued by Sun Microsystems in a trademark infringement suit over Microsoft's use of Sun's Java code that was settled for \$20 million in early 2003. In August 2003, a judge in another patent infringement case agreed with InterTrust Technologies that a number of Microsoft products infringed on InterTrust Technologies' digital securities patent. A \$521 million settlement was levied against Microsoft for infringing on a process patented by Eolas Technologies that was used in Microsoft Internet Explorer.

The internet has opened new avenues for patents and patent infringement lawsuits. For instance, in May 2003, a Virginia jury found that eBay, an internet auction site, had violated the patent of inventor Thomas Wooten who had developed the process for an online marketplace. Wooten could have insisted that eBay stop using his patented process, which would have put the highly profitable company out of business. The internet also came into play in a battle between America Online (AOL) and Microsoft in the late 1980s when AOL insisted that it had invented the Instant Messenger technology and unsuccessfully tried to prevent Microsoft from using Instant Messenger on the Microsoft Network (MSN).

A number of patent infringement lawsuits have also involved drug companies that have traditionally fought the development of generic drugs, and which have tried to hold onto patents as long as possible, denying consumers the option of choosing between high-priced name brand drugs and cheaper and equally effective generic products. Large drug companies have frequently charged generic developers with patent infringement. On August 19, 2003, the Food and Drug Administration (FDA) dealt a blow to the name brand drug companies by announcing that patents would henceforth be issued for no more than 30 months. After that period, developers of generic drugs were free to begin testing products in preparation for their manufacture. The FDA estimated that the move could save consumers as much as \$3.5 billion over a 10-year period.

In one case, the Type II diabetes medicine, Glucophage, which sold for 85 cents a tablet in September 2003 could cost as little as 19 cents a tablet in



generic form. While the drug companies have a right to protect their intellectual rights through patents of drugs, advocates say consumers also have the right to expect reasonable prices on items that can literally save lives.

#### SEE ALSO

trademark infringement; industrial espionage; pharmaceutical industry.

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## pension funds

PENSION FUNDS MAY be defined as forms of institutional investment, which collect and invest funds contributed by sponsors and beneficiaries to provide for the future pension entitlements of beneficiaries. In the United States, a solid majority of Americans own shares in major companies, often through pension funds, and thus have a stake in the market economy. Issues related with pension funds

are closely linked with the debate on corporate governance.

Undoubtedly, companies must feel that investors will reward them if they engage in more socially and environmentally responsible behavior. To provide such rewards, various socially responsible investment funds have been created. The conservative behavior of pension funds has persisted, in part, because trustees, however much they might wish to manage the pension funds according to their values, have typically felt that they could not simply vote their conscience.

They also came equipped with a restrictive definition of fiduciary responsibility. The responsibility of the pension fund trustees is to responsibly invest the earnings entrusted to them. The investor liability burden is assumed by pension-fund managers, while pensioners labor in good faith to make consistent contributions allowing long-term growth that will accrue earnings. Fund managers are absolutely accountable to the pensioners, who expectantly depend on the fund to provide for a worthy lifestyle during retirement. Until recently, pension funds have been defined to explicitly exclude making socially and environmentally oriented investments. This definition arose because of a pervasive economic belief that such investments were financially less attractive.

Since the beginning of the 1990s, there has been an ensuing debate on the role and status of pension funds in relation to corporate governance. In part, this debate has been driven by the rising role of institutional investors in the capital of multinational corporations. In the Western world, there has been wide-ranging debate about the role of pension funds in relation to the efficient allocation of resources. For example, there has been a long-running debate about whether the portfolio management practices of pension funds and their investment managers have contributed to (in a positive sense) the long-term efficient allocation of resources in the economy. Some commentators would argue that the preoccupation of institutional investors with short-term outcomes has adversely affected corporate management practice. Likewise, there has been some uneasiness about the capacity of pension funds and their investment managers to make meaningful contributions to the design of agency relationships between managers and shareholders. Every now and again, questions are raised in the financial press about the knowledge, competency,

and experience of pension-fund officers in relation to the management of corporations that are, more often than not, complex, multi-jurisdictional institutions.

In American capitalism, the vast majority of shareholders are either small retail investors, or huge pension funds, mutual funds, and insurance firms that manage diversified portfolios through investment managers. And those managers face conflicts of interest, for they have mandates from companies to manage corporate pension funds and provide insurance. The only large shareholders free of such conflicts are public-sector pension funds. They share a general inhibition with other large investors: The benefits of active involvement in steering corporate boards are low, whereas the resources used are high. It has made much more economic sense to be passive, not active.

Performance trends in the nation's 100 largest corporations are, with few exceptions, reporting inaccurate earnings. In the early 2000s, companies were reporting earnings based on growth projections to pension funds when, in reality, the same funds were actually depreciating in value. To make matters worse; the amateur investor has little knowledge of business writing reported in business account statements. The situation in the 1990s was truly exceptional when pension funds reportedly surpassed projected earning expectations. Subsequently, we saw a return to the norm for pension funds where, typically, plans generate an expense instead of a profit.

Since the 1980s, many companies have changed from traditional defined-benefits (DB) plans to defined-contributions (DC) plans such as 401Ks, which limit the company's liability and shift the risk onto the employees and retirees. But this change is only the most visible part of the story. As markets turned down in 2000, most companies with DB continued to bank on optimistic long-term asset return assumptions. DB purportedly reallocated funds to their profit statement even though the earnings will probably not be tangible for multiple years.

For years, pension plans were created to induce loyalty and long service in workers. by the 2000s, long-tenured employees were often deemed liabilities. The idea that pension funds would start failing was never considered. However, given the damage provoked by pension fund scandals, the George W. Bush administration and lawmakers decided to pro-

pose new rules for pension plans. The success of pension funds depends on a crucial factor: the investment rate of return.

A downward trending stock market can shrink their value, and in order to bridge the gap between companies' investment needs and the cover of pension liabilities, the Portman-Cardin bill aimed at boosting retirement savings. The bill, known as Protecting Americans' Savings Act, was proposed for consideration to the U.S. Congress in 2003. Subsequent to the Enron and WorldCom corporate accounting scandals, the bill would also impose a 50 percent excise tax on "golden parachute" payment to top managers when a company goes bankrupt.

Although pension funds hold some of the most important blocks of stock of major public companies, the chances of contesting a chief executive officer (CEO) are unlikely, with the exceptions of CalPERS, the California public pension system that names a "watch list" of troubled companies each year, and TIAA-CREF, which tries to push for change by meeting privately with CEOs and boards of directors. Also, many investors now distrust pension accounting because it distorts reported earnings. Criticism centers on the lack of transparency in the management of pension funds, especially in the distribution of profits.

#### SEE ALSO

Teamster Pension Fund; securities fraud; stock fraud; Enron Corporation; WorldCom.

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## perjury

**PERJURY IS INTENTIONALLY** lying under oath at an official court proceeding. The false statement could occur in testimony in court, depositions, di-

verse administrative hearings as well as in written legal documents such as affidavits, deeds, license applications, and tax returns. In societies as diverse as ancient Greece and Rome, the Ashanti in Africa, Native American tribes, early modern England and contemporary Europe and North America, perjury has been considered one of the most despicable of crimes since it involves a brash moral wrongdoing. Usually oaths are sworn in relation to God; breaking such an oath is seen as an offense against God. Moreover, it is regarded as an act of disobedience against the government not unlike tax evasion, contempt, and bribery. It was brought to the public spotlight in the mid-1970s when a number of officials in the Richard M. Nixon administration, such as H. R. Haldeman, John Erlichman, and John Mitchell, became household names for perjuring themselves in relation to covering-up illegal break-ins and surveillance of the Democratic Party. Recent public opinion surveys reveal that it is still considered a particularly odious crime.

Nevertheless, in the modern era convictions for perjury have been extremely rare. A common refrain in the legal community is that perjury is widespread, but is rarely prosecuted. It is particularly difficult to prove since it requires substantial evidence to demonstrate that a statement is false, that it was made intentionally, and that it is relevant to the case. Common defenses by those charged with the crime often center on the argument that they were simply mistaken or confused. Perjury has been frequently associated with serious criminal cases in which witnesses lie on the witness stand. In civil law, perjury has been found largely among corporate and white-collar offenders involved in fraud and illegal financial practices. Due to the complexity of proving perjury, it has been acknowledged that it is quite possible to openly deceive and mislead as long as what you swear is literally true.

## HISTORY OF PERJURY

In the Anglo-American tradition, perjury is generally traced back to 16th-century laws established in England. Yet it is valuable to outline what constituted perjury or, more generally, false witness in societies before this period as it illustrates the premium placed on moral behavior under the law, a development within which modern-day formulations have evolved. In the ancient Code of Hammurabi, perjury was punishable by death. In the

Greek city state of Athens, the act of lying in legal proceedings was widely recognized and formed a significant portion of cases brought to the courts. Indeed, one scholar claims that it was much more common than today. While there was no serious criminal sanction against the act, persons alleged to have perjured themselves were subject to serious public disgrace and sometimes fines. Likewise in Roman law, perjury was considered a moral disgrace and in the early period of the empire was sometimes punishable by death. Historians have found evidence that under the reign of the emperor Charlemagne (768-814) perjury was punishable by physical mutilation. There is also considerable evidence in non-Western societies of false witness as a morally abhorrent offense against the deities.

In medieval England, perjury was considered an offense in the various state and church courts. In general, it consisted of all those offenses related to the breaking of an oath in formal legal settings. Although there was no perjury in the modern sense in which a witness intentionally lies on the witness stand, such an infraction was punishable at the time under a different law called maintenance. Perjury in this era was a demonstrably broader offense than today. In the case of lawyers and some government officials, for example, the oath to uphold the law that they swore when they entered office was used to prosecute them for perjury when they were found to have engaged in illegal activities.

An untrue verdict in a common law case was deemed perjury. False financial returns by sheriffs were likewise regarded as perjury and false witness in a church court was subject to punishment. The act of lying in a formal legal setting was thus complex and was interpreted in various manners depending on the nature of the court which was trying the case. In addition, there was still a strong moral element to the term in legal and popular usage associated with dishonor toward God.

In 1563, the Statute of Perjury was passed in England. It was conceived as a way to increase penalties for the existing crime of perjury, but it did little to clarify the ambiguous meanings and interpretations bequeathed from medieval times. According to legal historian Michael Gordon, the notion of perjury as a broad offense committed when persons broke oaths continued into the early 17th century. It also encompassed notions of conspiracy, that is, colluding with others to subvert the law. There was a growing concern among judges,

however, that the perjury statute and common law findings on the issue were haphazardly applied and that consequently, it had the potential to deter witnesses from coming forward and testifying truthfully. It was for this reason that judges in the 17th century sharpened the meaning of the statute, creating in the process a common law notion of perjury which exists in its basic form to the present.

During the long reign of Queen Elizabeth (1533–1603), perjury maintained a strong moral component related to religion. The church courts still in existence at this time had responsibility for perjury committed under its auspices. In state courts, however, it was gradually systematized and later added to existing statutes.

The first key principle developed at the time was that perjury had to be willfully intended; it could not result from mistakes or even from misleading and equivocal statements. This had originated in religious teachings that were intended to give witnesses and defendants a way out of the so-called perjury trap, the act of implicating yourself in false statements. A second requirement was that perjury had to originate in proper judicial procedures, that is, in a formal legal proceeding.

You could not be charged with perjury for something you said outside of a court. Less obvious but still crucial, as Michael Gordon argues, was that the false swearing had to be related to the substance of the court proceeding, a concept later known as materiality. Typical cases involved false financial statements made orally or in writing, forcing others to lie in court, and false affidavits. It was considered a misdemeanor in English law and was regarded as relatively rare due to the increasingly complex nature of the rules.

The early American colonies inherited these common law principles and extended them through laws and constitutional provisions. The federal government and courts drew explicitly on the law of perjury developed by the judiciary in England after the 16th century. In early America, the crime of perjury was regarded in the more serious category of criminal law as a felony.

Typical statutes in the early years of the colonies provided for sanctions of fines, imprisonment, and hard labor as penalties for willful lying before the courts, swearing false statements, and persuading others to commit perjury. In the colony of New York, one of the penalties included the branding of a “P” in the forehead of the person

convicted, although this harsh form of punishment was apparently exercised rarely.

## PERJURY STATUTES

Modern American law has somewhat extended the scope of perjury and provided for precise definitions of its various components and what is necessary to prove the offense. According to Stuart Green, federal perjury statutes comprise five key elements that are required to prove that perjury was committed: “1) an oath authorized by a law of the United States; 2) taken before a competent tribunal, officer, or person; 3) a false statement; 4) willfully made; 5) as to facts material to the hearing.”

At the state level, there are a number of differences. In New York, for instance, the crime of perjury was divided into degrees in 1935 and the requirement of materiality was eliminated. Materiality can, however, be used to decide the degree of the crime. Perjury in the first degree is considered a felony while the lesser second-degree perjury is a misdemeanor. Therefore, proving perjury is a difficult task, involving a number of complex legal principles. The question of morality, especially the differences between lying and misleading statements, continues to be a much-debated question, as does the responsibility of lawyers to allow lies and/or misleading statements to go unchallenged in court.

Take the landmark case of *Bronston v. United States* in 1973. Bronston, a movie company president, was involved in a bankruptcy case. At a hearing, he was asked “Do you have any [Swiss bank accounts]? He replied “No.” The follow-up question asked, “Have you ever?” He replied, “The company had an account there for about six months in Zurich.” In reality, Bronston had had Swiss bank accounts for five years, but not at the time of the trial. He first answer was strictly correct. If he had said “no” to the second question he would have been found guilty. What he in fact did was give a truthful answer to a question that had not been asked. Bronston was clearly misleading the court, but he had not said anything false. The lawyer failed to pursue Bronston on this misleading statement and the conviction was subsequently overturned.

In a contrasting case, *United States v. DeZarn*, a different conclusion was drawn from a similarly misleading statement from a trial defendant. DeZarn was prosecuted for perjury in a case under

the Hatch Act, which bans the solicitation of government employees in political campaigns. DeZarn was present at two horse-racing parties in 1990 and 1991. DeZarn conducted fundraising only at the 1990 party. The lawyer meant to ask DeZarn about events at the 1990 party, but erroneously said "1991." DeZarn truthfully answered that no fundraising activities had occurred at the 1991 event. This misleading statement, however, was regarded by the courts as different from the Bronston case since it entailed a responsive answer given to the question. Hailed by some legal observers as "nudging federal criminal law closer to everyday morality," it has also been criticized as unfairly blurring the distinction between lying and misleading. This debate reveals that competing notions of morality and what role they should play in law continue to be controversial. It furthermore demonstrates that errors by legal counsel may play a crucial role in perjury cases.

#### CORPORATE PERJURY

Cases involving corporations illustrate the difficulties of securing convictions for perjury. In the mid-1990s, tobacco company executives, for example, appeared before a committee of the House of Representatives claiming that they did not believe nicotine was addictive. Of course, beliefs by themselves do not constitute perjury. Nevertheless, documents made public after these appearances made it abundantly clear that tobacco company officials have long concluded that nicotine is indeed addictive and have built their marketing strategies on this very fact. For decades, tobacco companies have also sworn to state and federal agencies that cigarettes have few health effects, knowing full well that they are harmful. Yet no perjury charges have ever been laid against executives in this industry.

The high-profile tobacco industry has not been the only culprit. In 1991, the secretary of labor stated that there had been a consistent pattern of irregularities on dust sampling tests conducted by coal companies. Five hundred mine operators had submitted tests that supposedly demonstrated that their mines had been properly vacuumed. These tests are used to make sure miners are not exposed to toxic levels of coal dust which lead to a number of debilitating diseases. Yet attempts to prosecute the companies failed because they were able to argue in court that the tests may have been poten-

tially mishandled and therefore they were not guilty of false statements. Successful cases of perjury in recent years include that of Hudson Foods which was indicted in December 1998 for lying to the Department of Agriculture in an attempt to stop a recall of 25 million pounds of hamburger meat, some of it infected with *e. coli*. Even the unlikely cruise ship company, Royal Caribbean Cruise Lines, was discovered to have illegally dumped oil waste in the Gulf of Mexico as well as disposing of physical evidence related to the crime and revising their log book to hide the discharges.

#### POLICE PERJURY

Perhaps the most prevalent area of perjury in modern society has emanated from law-enforcement officials themselves. This has long been charged by critics of the justice system. Police departments and officers across the country have been charged with numerous cases of what Christopher Slobigin calls "testilying" in recent years. The Mollen Commission, charged with investigating corruption in the New York City Police Department in the early 1990s, found that it was common for police officers to perjure themselves at various stages of the criminal process. Interviews with police officers found that it was usual to falsely claim in police reports and swear under oath that suspects had committed offenses, such as running a red light or that they saw contraband inside the car. To hide an unlawful search, police may claim they saw a bulge in a person's pocket. To enter apartments, they concoct stories that unidentified civilians had seen drugs inside the residence. To arrest people they believe are guilty of drug trafficking, they falsely contend that the defendants had drugs in their possession when, in reality, drugs were found in a place where the officers were not allowed to search.

False statements by police on the application form and in oral testimony to the warrant magistrate has been noted by many observers. According to Slobigin, "In one survey, defense attorneys, prosecutors, and judges estimated that police perjury at Fourth Amendment suppression hearings occurs in 20 to 50 percent of the cases." He concludes that "Few knowledgeable persons are willing to say that police perjury about investigative matters is sporadic or rare, except perhaps the police, and ... even many of them believe it is common enough to merit a label all its own."

In sum, perjury has long had a strong moral component and for this reason it has been regarded as a particularly heinous crime. For this very same reason, it has evolved into a complex and exceedingly difficult crime to prove. Legal observers have long complained that lying and other forms of false swearing are ubiquitous yet are seldom prosecuted. In the white-collar and corporate crime area, they have argued that the only remedy for this sorry state of affairs is devoting more resources to investigating examples of perjury, and seriously prosecuting suspected cases as well as developing sharper concepts of perjury which punish clearly untruthful statements regardless of legal technicalities.

#### SEE ALSO

Mollen Commission; coal mining; corporate criminal liability; ethics; police corruption.

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## pesticides

IT IS UNLIKELY that most Americans would voluntarily consume poisonous substances, yet millions of people unknowingly consume poisonous residues on fruit and vegetables that they eat every

day. Pesticides are useful tools in agricultural work because they kill insects and reverse conditions that interfere with the growth of agricultural products.

However, it is virtually impossible to remove all residues before products are sold and consumed. While it is advisable to wash all fruit and vegetables thoroughly before consuming them, the process will not remove all pesticide residues. In addition to the dangers that pesticides pose to individuals who consume trace amounts on food products, pesticides that are not handled properly can create a host of problems for agricultural and horticultural workers. Even if it were possible to remove all pesticides from such products, exposure to pesticides would likely continue because traces of pesticides are frequently used both indoors and outdoors in almost all homes, apartments, schools, businesses, hotels, restaurants, parks, golf courses, and other places that people frequent. Pesticide residues are also found in water, sidewalks, bedding, furniture, baby toys, and other items that are part of everyday lives. Numerous studies have shown that exposure to pesticides can cause cancer, respiratory disorders, neural damage (as in Parkinson's Disease), immune system damage, endocrine system dysfunction, reproductive problems, and other less serious problems.

Children are particularly vulnerable to pesticides in foods and the environment. In 1999, the Environmental Protection Agency (EPA) announced strict limitations on methyl parathion and azinphosmethyl, two pesticides that were commonly used in growing peaches and apples, because they were suspected of causing neurological damage in infants and children. A study of pregnant women in New York City released in January 2003 by Dr. Gertrud Berkowitz of Mount Sinai School of Medicine revealed that unborn infants were being exposed to pesticides at 60 to 120 times the EPA tolerance levels. Berkowitz's overall conclusion was that urban homes might be even more toxic than agricultural residences.

A report from the Centers for Disease Control and Prevention (CDC) published in April 2003, which examined the presence of 116 separate chemicals (including 34 pesticides) in thousands of participants, revealed that metabolites of chlorpyrifos were twice as likely to be found in children aged 6 to 11 than in adults. While infants and children are at greater risk from pesticide exposure, pesticides also affect the health and lives of the adult population

on a global basis. In 2003, a controversial Belgian study found pesticide residue in the blood of 159 women with breast cancer. Studies in North Carolina and Iowa uncovered a correlation between exposure to pesticides and the risk of prostate cancer in males whose work involved pesticide application. Traces of various pesticides, antibiotics, aspirin, and Prozac have been found during tests on wastewater treatment plants. Pollutants from paper mills, power plants, and garbage incinerators that wind their way to the ocean are thought to be responsible for the presence of mercury in fish that continues to be an issue with environmentalists and consumers.

### PESTICIDES IN DEVELOPING COUNTRIES

During the period between World War I and World War II, a typhus epidemic led to the deaths of 3 million people in Africa. It is possible that the epidemic would have spread even further had the West not coordinated the effort to stop the disease at its



*Orchard workers are the most susceptible to diseases from pesticides sprayed on fruit to make them look appealing.*

source. Because typhus is spread by lice, in 1943 the Western countries launched a delousing program in Nigeria. Decontamination was accomplished by mixing DDT with an inert powder and blowing it on to the clothes of Nigerians. It was estimated that within two hours of contact, all body lice had been destroyed, thus, averting a worldwide typhus epidemic. DDT was also used successfully in mitigating the effects of outbreaks of malaria in Kenya in the 1940s and in Uganda in the 1960s. After evidence about the toxic effects of DDT surfaced in the 1970s, the United States and other countries banned its use. Some developing countries, however, continued to use DDT into the 21st century.

While governments in most developed countries have made great strides in regulating the use of pesticides, authorities in developing countries have worked at a much slower pace. Part of the problem is that governments in these countries must balance the danger to residents against the much-desired profits that boost local economies. Foreign businesses have proved mixed blessings for developing countries by using pesticides that are banned in their own countries. One example of this practice can be found in the floriculture industry, which has provided around 190,000 jobs in countries like Colombia, Mexico, and India. While these jobs boost local economies, workers in the floriculture industry have been exposed to pesticides such as organophosphates that may negatively affect the reported to produce infertility, miscarriages, and birth defects. Approximately two-thirds of such workers also regularly complain of headaches, dizziness, and blurred vision.

The fruit-growing industry has also produced health problems for workers in developing countries. In the early 1990s, a class action lawsuit was filed by banana workers from Costa Rica, Ecuador, Guatemala, Honduras, Nigeria, and the Philippines, charging Amvac, Dow Chemical, Occidental Chemical, and Shell Oil Company with exposing them to the dangers of DBCP (dibromochloropropane). In 1993, a \$25 million settlement was announced. In the winter of 2003, Dow Chemical, Shell Oil Company, and Standard Fruit Company (Dole Food Company) were ordered to pay \$490 million to 583 Central American banana workers who had been exposed to the highly toxic Nemagon that had caused infertility.

Some workers also experienced impotence, depression, and stomach cancer when exposed to the

substance. Other cases against Dole, Chiquita, and Del Monte continued to wind their way through the courts.

The use of pesticides in developing countries was brought home to many Americans during the Persian Gulf War in 1991. After returning to the United States, a number of veterans complained of health-related problems that included joint pains, sleep disorders, memory loss, and fatigue. It has been documented that at least 35 separate pesticides were used during the war, and a number of these have received special attention from the Office for Special Assistance for Gulf War Illnesses (OSAGWI) because of known toxicities or frequency of complaints by Gulf War veterans.

Lindane, which was used as a delousing agent, has been known to cause hyperactivity, excitability, tremors, seizures, and comas. Organophosphate compounds, used to exterminate flies, spiders, cockroaches, and other sucking and chewing insects, was credited with causing tremors, severe muscle contractions, dizziness, shortness of breath, vomiting, sleep disorders, depression, and anxiety. Carbamates, used to kill a wide range of insects were believed to cause fatigue, joint pain, sleep disorders, headaches, and skin problems as well as cognitive, mood, and other neurological effects.

## FEDERAL REGULATION

The first federal efforts to regulate the manufacture, distribution, and use of pesticides resulted in the Insecticide Act of 1910 that banned the manufacture, sale, and transport of the misbranded, toxic, and useless pesticides that were available. Regulations on pesticides were strengthened with the passage of the Food, Drug, and Cosmetic Act of 1938. One section of the law, known as the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), gave the government the authority to pull illegal pesticides from the market and to suspend or deny licenses to violators.

A 1954 amendment to the law called for the establishment of tolerance levels for all pesticides used in food and food products. In the wake of the consumer rights movement of the 1960s, increased attention was paid to the use of pesticides in food. This was partly due to the publication of Rachel Carson's *The Silent Spring* in 1962 that served as an environmentalist wake-up call to the American public. The public was also outraged when re-

searchers began documenting the impact of using pesticides on farm workers and rural residents. The Environmental Pest Control Act of 1972 gave the government even more authority, and amendments in 1975 and 1978 further strengthened the government's role in protecting consumers from harmful pesticides.

Congress reacted to increase public attention on environmental issues by passing the National Environmental Policy Act (NEPA) of 1969, which established the Council for Environmental Quality and mandated an emphasis on integrated pest management (IPM). Regulation of pesticides suffered a setback in the 1980s when the agricultural sector fell victim to the economic crisis that resulted from Ronald Reagan's trickle-down economics. In 1986, Reagan proposed eliminating funding for the Extension Services and the IPM implementation program, but Congress refused to comply. In 1994, the Department of Agriculture announced renewed federal efforts toward controlling pesticides, stipulating that IPM methods must be employed on at least 75 percent of all crop acreage by 2000.

In 1996, Congress passed the Food Quality Protection Act (FQPA), which gave the EPA the authority to regulate pesticides by requiring that producers and users of pesticides show with reasonable certainty that no harm would result from aggregate use of a product. The new law required the EPA to re-regulate pesticides every 15 years based on most recent data. Congress ordered the EPA to produce a revised list of the most toxic pesticides, with special attention to the impact of toxins on infants and children.

While environmentalists and consumer advocates discourage the widespread use of pesticides because of their harmful affects on human health and the global environment, the agricultural sector defends pesticide use, insisting that pesticides promote better quality food products that are more esthetically appealing.

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water pollution; Environmental Protection Agency; Food, Drug and Cosmetic Act; United States.

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## pharmaceutical industry

HEALTHCARE in the United States has become a megabillion-dollar business. It is responsible for over 12 percent of the gross national product. Revenues from the health industry, which currently exceed \$360 billion a year, are second only to those of the defense industry. True profits are much higher. In 1991, the United States spent \$750 billion on healthcare and the level of spending is increasing each year.

A key component of the health industry, the pharmaceutical business has one of the worst records when it comes to breaking the law. John Braithwaite, in his extensive and illuminating study, shows the profundity and gravity of the crime problem in the pharmaceutical industry. Bribery, corruption, the unsafe manufacturing of drugs, fraud in testing, false advertising, and price-fixing are just a few of the numerous crimes the pharmaceutical industry has engaged in. Braithwaite's research was conducted between 1977 and 1980 and published in 1984, over 20 years ago; unfortunately, not much has changed. The pharmaceutical industry is still involved in malfeasance.

According to the *Multinational Monitor* which listed the top 100 corporate crimes during the 1990s, 31 of the top 100 involved pharmaceutical companies. Some pharmaceutical makers have a

long history of inadequately testing new drugs and products that eventually harm others, particularly women or their children. The organization and operation of the pharmaceutical industry may be a salient factor in understanding the crimes that are committed.

## RESEARCH AND PATENTS

The pharmaceutical business incurs tremendous costs in bringing a new drug or medical device from concept to market. These costs generally fall into four areas: Research & Development (R & D), the Food and Drug Administration (FDA) approval process, manufacturing, and advertising. Research and development is by far the most costly of the four and an area that is most open for fraud.

Pharmaceutical companies face great temptations to mislead health authorities, the FDA in particular, about the safety of their products. The companies expend an enormous amount of money, upfront, in the research of new drugs and are in great competition to be the first that obtains approval and a patent for the new discovery. With drug development, potentially hundreds of millions of dollars must be invested for a new compound that may never return a profit and, in a best-case scenario, will only begin returning money 12 to 15 years out. If another company gets its product on the market first, then a massive amount of money and time, already expended, is lost, not to mention the loss of future profits the company would have received if its drug were the one to obtain the market's share.

Currently, patents last for 20 years. The 20-year term is codified in 35 U.S.C. Sec. 154. Twenty years may seem like a lengthy and sufficient amount of time, but the 20-year term begins on the date of the patent application. This is very important for drug manufacturers, because drugs are generally patented before beginning the FDA approval process. Because the approval process can take so long, the "effective life" of the patent (the number of years left on a patent) is often less than half the original life once the product is actually available.

This creates a race to be the first company with the new drug on the market. In 2002, Pharmaceutical Research and Manufacturers of America (PhRMA) member companies invested an estimated \$32 billion on research to develop new treatments for diseases. PhRMA member companies

spend more on R&D than the National Institutes of Health and the international pharmaceutical industry. The industry invested more than \$30 billion in 2001 in discovering and developing new medicines.

## CLINICAL TRIALS

Given the enormous amount of money at stake, clinical trials are extremely important in order to move from research and development to obtaining a patent and FDA approval. Clinical trials are another place where fraud may manifest itself given the financial stakes. Research has shown that data from clinical trials have been falsified and adverse effects have been ignored, and in some egregious cases, covered up. According to Braithwaite, between 1977 and 1980 the FDA discovered 62 doctors who had submitted manipulated or downright falsified clinical data. A study conducted by the FDA revealed that one in five doctors investigated, who carry out field research of new drugs, had invented the data they sent to the drug companies, and pocketed the fees.

According to the FDA, if the data proves to be unsatisfactory toward the drug being investigated, it is not unusual for the drug company to continue trials elsewhere until satisfactory results and testimonials are achieved. Unfavorable results are rarely published and those who conducted the tests with adverse findings are pressured into keeping quiet about such data. It is very easy for the drug company to arrange appropriate clinical trials by approaching a sympathetic clinician to produce the desired results. The incentive for clinical investigators to fabricate data is enormous. As much as \$1,000 per subject is paid by American companies, which enables some doctors to earn up to \$1 million a year from drug research, and investigating clinicians know all too well that if they do not produce the desired results, then the loss of future grants and work is to be expected.

Even if data obtained from clinical trials is not falsified, it may be of little worth, because the trials may not have been performed appropriately. Many trials involve relatively small numbers of people and the true harmful side effects of a new drug may not appear in those small numbers. Harmful side effects may only appear once the drug has been mass marketed and widely used and, by then, it may be too late for the general populace. Furthermore, the

subjects taking part in the trial usually do not represent those who will use the drug after its approval. Very young or elderly people, women of child-bearing age and people with liver or kidney disease are usually not included in clinical trials, although such people may be given the drug after it is marketed.

Optimal dosages for adults are calculated based on what is most effective for an average-sized adult. Many adults differ from this average, and many may react atypically to some classes of drugs. Many of these reactions are adverse and can cause great harm. According to the FDA, every year, an estimated 140,000 Americans are killed because of the drugs they are taking. Patients suffering from adverse drug reactions take up one in seven hospital beds in the United States. These estimates are probably much lower than actual estimates given that many adverse drug reactions go unreported or undiagnosed.

## DRUG MARKETING

Once a drug makes it through the trials and is approved by the FDA, then it needs to be produced and marketed. The major effort of marketing campaigns is done through the help of physicians, since they will be prescribing the medications to their patients. There is a vast amount of available drugs on the market and the goal of each pharmaceutical company is to have its drug recommended by the prescribing physician. According to Dr. Alan Levin, as stated in his book, *Dissent in Medicine: Nine Doctors Speak Out*, a major reason why health care is in such a shambles is that the medical establishment has allowed itself to be "bought off" by the pharmaceutical industry.

Drug companies expend a great amount of effort to attract the allegiance of practicing physicians, which is done through various aggressive advertising efforts. These advertising efforts can vary from modest gifts to extravagant grants. Drug companies employ many means in bribing medical students, doctors, medical schools, and hospital administrators. Some drug companies have been known to woo young medical students by offering them gifts, including expense-paid trips to conferences and offers of student research grants. Medical schools are given large sums of money for clinical trials and basic pharmaceutical research.

Drug companies regularly host lavish dinner and cocktail parties for groups of physicians. They



*All phases of pharmaceutical manufacturing are subject to fraud, from research funding to clinical testing to marketing and distribution. The act of fraud in these cases often leads to tragic, life-threatening consequences.*

provide funding for the establishment of hospital buildings, medical school buildings, and “independent” research institutes. These “gifts” have become a massive marketing tool and campaign to help mold the attitudes, thoughts of students, and policies of practicing physicians.

Fifty percent of drugs on the market today did not exist 10 years ago. With so many new drugs, doctors do not have time to learn about them in medical school or have the time to keep up with all the changes once they are practicing physicians. The busy physicians, therefore, rely mainly on the drug company’s sales representatives to inform them about new medications and devices. Drug companies hire sales representatives who regularly and frequently visit physicians’ offices to dole out drug samples. They explain the indications for these drugs and try to persuade physicians to utilize their products.

Like any other salesperson, they disparage the products of their competitors while glossing over the shortcomings, or potential strong side effects of

their own product. Most sales representatives do not have formal medical or pharmacological training and are not regulated by any state or federal agencies.

According to the *American Journal of Medicine* in 1982, 46 percent of physicians reported that drug representatives are moderately to very important in influencing their prescribing habits. In a 2003 study, one-third of medical residents reported that they change their practice based on information provided by drug reps. In another study, 61 percent of medical residents stated that industry promotions did not influence their own prescribing, but only 16 percent believed other physicians to be similarly uninfluenced.

In addition to the billions of dollars pharmaceutical companies spend on research and development, and incentives to physicians, drug makers spent an estimated \$1.9 billion on direct-to-consumer (DTC) advertising in 1999. Prior to the 1990s, DTC advertisements of prescription drugs were severely restricted. Prior to 1997, advertising

had to be accompanied by all of the fine print that would normally go on a label and package insert, but in August 1997, the FDA relaxed restrictions on DTC advertising, leading to a boom in television and radio ads and advertising spending.

According to the National Institute for Health Care Management Research and Educational Foundation, \$2.5 billion was spent on advertising to consumers in 2000. Increases in the sales of the 50 drugs most heavily advertised to consumers were responsible for almost half (47.8 percent) of the \$20.8 billion increase in spending in 2000. In 2000, Merck spent \$161 million on advertising for Vioxx. That is more than Pepsico spent advertising Pepsi (\$125 million), and more than Anheuser-Busch spent advertising Budweiser (\$146 million). The increase in Vioxx sales in 2000 accounted for 5.7 percent of the one-year increase in drug spending. According to industry estimates, drug companies spent \$15.7 billion on promotion in 2000. Also in that year, \$7.2 billion worth of free samples were distributed.

## UNSAFE PRODUCTS

Unsafe medical devices or drugs can have a devastating effect on many people; historically, women and their unborn babies have been the most victimized. A long list of drugs that have had major complications, including causing death, would cite: Paracetamol (a painkiller) caused 1,500 people to be hospitalized in Great Britain in 1971; Orabilex caused kidney damages with fatal outcomes; MEL/29 caused cataracts; Methaqualone caused severe psychic disturbances leading to at least 366 deaths, mainly through murder or suicide; Isoproterenol (for asthma) caused 3,500 deaths in the 1960s; Stilboestrol (for prostate cancer) caused cancer in young women; Trilergeran (anti-allergy) caused viral hepatitis; Phenformin (for diabetes) caused 1,000 deaths annually until withdrawn; Debendox (for nausea) and Accutane (for acne) both caused birth defects. Two of the most egregious cases of corporate malfeasance in relation to unsafe drugs include DES and thalidomide.

Diethylstilbestrol (DES) was initially hailed as a wonder drug that could do everything, including curing the problems of menopause, treating prostate cancer, preventing miscarriages, and making babies healthier. But DES turned out to have tragic consequences, especially for babies who were

exposed to DES in the womb. Two major studies that were conducted and published in 1953 showed that DES was definitely not a wonder drug. The studies concluded that the drug did not decrease the number of miscarriages; it had no effect on lowering the rate of prematurity; and it did not increase the health of premature babies. On follow-up studies, the effects were even more disturbing. There was a statistically significant increase in the number of miscarriages, premature births, and neonatal deaths, not the opposite as the drug was marketed. The pharmaceutical manufacturers focused on positive information and downplayed all negative findings. Twelve years after the first studies were conducted, more than 100,000 prescriptions of DES were still given to pregnant women.

Another drug that caused an enormous amount of irreparable harm to pregnant women and their children across the globe was thalidomide. It was used as a tranquilizer or sleeping pill and was being touted as a drug with no side effects. It was also used to treat morning sickness during pregnancy. With its lack of side effects, it was deemed safe enough that it did not require a prescription; therefore, it was widely available over the counter. Numerous women who used thalidomide during pregnancy bore children with extreme congenital abnormalities. Many of the children were born with their extremities attached in odd places. For example, toes attached to the hips or their hands and feet were attached directly to the torso, there was no development of arms and legs. Shortly after the birth defects were observed, thalidomide was banned worldwide, but it was too late for thousands of babies. An estimated 8,000-80,000 children in nearly 50 countries were born deformed because thalidomide had been marketed as being safe to use by pregnant women. Because of this, it became known as the "drug that deformed." The FDA never approved the distribution of thalidomide in the United States until recently in controlled circumstances, and not for pregnant women.

Another area of concern in the testing of new drugs and/or products is the use of pregnant animals to test for human pregnancy effects; the efficacy of these tests are questionable. Because of the thalidomide tragedy, there has been a massive increase in the use of animals that are pregnant in drug testing, but this has failed to prevent further deformities. On the contrary, malformations have increased. It has been found that every year more

than a quarter of a million babies (1 in 12) are born with birth defects in the United States. Research has shown that the animals that are used in the testing phase do not really simulate human biology and therefore are not really showing the possible effects the drugs may have on unborn human children and the women who are pregnant.

The production and distribution of unsafe drugs is only one of the many areas controlled by the pharmaceutical companies. Unsafe products have also had devastating effects, as in the case of the Dalkon Shield. The Dalkon Shield was seen as a revolutionary and extremely effective IUD contraceptive device in the 1960s. The device was supposed to be almost 100 percent effective in preventing pregnancy and it was reversible, and did not have the side effects of the birth control pill. Unfortunately, the Dalkon Shield created pelvic infections in women and had a devastating effect on their future reproductive health. In addition, the Dalkon Shield was not effective as a method of birth control and those women who became pregnant, had septic abortions, and many of the women died from septic infections after becoming pregnant. Approximately 5 percent of the women wearing the Shield, 110,000 women, became pregnant and an estimated 60 percent suffered miscarriages.

With a better understanding of how the pharmaceutical industry operates, it is not surprising to see the endless possibilities for fraud and other malfeasance or criminal activity. Falsifying data in trials is only one of the many types of criminal activity the pharmaceutical industry has been accused of, and from which prosecutions have resulted.

Price fixing is another type of fraud committed. In April 2000, three former executives of BASF AG and one former executive of Hoffmann-La Roche Ltd. agreed to plead guilty, serve time in U.S. prisons, and pay criminal fines for their roles in an international conspiracy to suppress and eliminate competition in the vitamin industry. The conspiracy lasted from 1990 until 1999 and affected the vitamins most used as nutritional supplements, or to enrich human food and animal feed.

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healthcare fraud; Dalkon Shield; Food and Drug Administration; thalidomide; Braithwaite, John.

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## Poland

AFTER THE COLLAPSE of the Soviet Union, Poland moved with alacrity to establish a market-oriented economy. The transition was problematic. While elected officials were instituting new legal frameworks for business, including commercial codes, and tort, civil and contract law, white collar and organized criminal gangs in Poland quickly garnered significant profits through a wide array of illicit activities.

Like other former Soviet Union-dominated communist countries throughout Eastern Europe, Polish regulators and law enforcement agencies were ill-equipped to differentiate between legitimate and illegal profit-seeking activities, especially in an era where legal and regulatory standards were slowly evolving. As a result, white-collar and organized crime flourished in Poland throughout the 1990s, and efforts to combat criminal activities were sporadic and ineffectual.

Despite increased efforts to combat criminal activity, Poland remains a major transit point for narcotics trafficking to Western Europe. Criminal gangs also routinely raise illicit proceeds through auto theft, extortion and counterfeiting schemes, and securities fraud. Polish criminal networks are also linked to the smuggling of alcohol, tobacco, fuel, and bulk commodities, especially coal and metallurgical products. According to Polish government estimates, organized crime activity generates criminal proceeds in the range of \$1.5 billion to \$3 billion annually. This money is laundered through

Polish banks, currency exchange businesses, and casinos. Although Poland is not the leading jurisdiction of choice to launder proceeds for major criminal organizations from Russia, and Ukraine, the weak regulatory environment during most of the 1990s also enabled organized criminal gangs from neighboring states to transfer funds through Polish financial institutions to offshore financial centers.

Poland also suffers from widespread white-collar crime. The large degree of white-collar crime is linked to historical factors, especially an entrenched pattern of bribery, originating during the Soviet era, that remains an integral part of the political and economic process, and an immense civil servant class that makes governmental processes obscure and impede transparency. White-collar crime is also facilitated by elite cronyism and clan-like connections in the Polish business community. Consequently, Poland is routinely targeted by Polish media groups, non-governmental organizations, and international agencies, including the World Bank Group, which issue reports highlighting the link between white-collar criminals and government officials in the judiciary, law enforcement, and security services.

The proceeds of white-collar and organized crime are routinely laundered through Polish financial institutions. Launderers use Polish financial institutions to transfer funds to Western European states that are in close proximity to Poland. The Polish economy, large by regional standards, offers many avenues to launder illicit proceeds through its correspondingly large gray economy, promoted by a complex tax regime. Moreover, as a transit state between the European Union and the former Soviet Union, with a port on the Baltic, Poland has attracted organized crime groups from Western Europe and the Russian Federation. Funds are placed in banks, insurance companies, currency exchange shops, real estate, and short-term bonds. Although some of the proceeds of crime almost certainly leave the country, illicit profits are routinely invested in legal businesses, such as hotels, restaurants, and gambling parlors.

Since the mid-1990s, efforts to combat white-collar crime and organized crime in Poland have improved substantially. To limit the passage of illicit funds from organized criminal and white-collar crime through domestic banking and non-banking financial institutions, Poland initiated a rudimentary anti-money laundering regime with the passage

of the 1992 banking regulation, Resolution Number 16, which required Polish banks to report suspicious transactions. Additional measures were adopted through the 1990s. In 2000, the Sejm, the Polish Parliament, instituted a comprehensive anti-money laundering policy with the adoption of the Law on Counteracting the Introduction of Funds From Illegal or Unrevealed Sources Into Financial Turnover.

This law, which came into effect on June 23, 2001, established a financial intelligence unit, and mandated the reporting of all transactions worth more than approximately \$8,800. The law also mandated reporting requirements to include a broad range of non-bank financial institutions, especially brokers, investment and trust funds, insurance companies, casinos, money exchange shops, the Polish Post Office, leasing and factoring companies, pension funds, notaries, and real estate agents. Record keeping requirements for such transactions requires the maintenance in a database of information regarding the identity of the account holder owner of the funds for five years.

Additional steps taken by Poland to combat white-collar and organized criminal activities were instituted to meet international norms, and ensure entrance into the European Union. To combat domestic white-collar and organized criminal activity, Poland increased international cooperation with the ratification of a series of significant international conventions, including The Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime in December 2000, and the United Nations Convention Against Transnational Crime in December 2001. The ratification of major international conventions in Poland formalized links to European law enforcement agencies, and ensures international cooperation in the battle against transnational criminal groups, and the passage of illicit funds across European borders.

#### SEE ALSO

money laundering; corruption; bribery; public corruption; Russia; human trafficking; organized crime.

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## police brutality

USE OF FORCE by the police falls under the Fourth Amendment to the Constitution because it involves the “seizure” of a free citizen. Whether a use of force is “brutal” (or excessive) is case-specific and hinges on whether the act was objectively reasonable under the circumstances (*Graham v. Connor*, 490 U.S. 386, 1989). Excessive force by jail and prison personnel constitutes “cruel and unusual punishment” under the Eighth Amendment.

Excessive use of force by officers of the criminal justice system, if found to be intentional, is punishable by state statutes covering crimes of violence (assault, rape, and homicide) and by the federal statute 18 U.S.C. §242. The latter covers “Deprivation of Rights Under Color of Law,” and punishes by up to a year in federal prison any person acting under color of law who intentionally and wrongfully uses excessive force, or by as many as 10 years if there is bodily harm or a dangerous weapon is used, or by as much as life imprisonment or the death penalty if the harm inflicted caused death, was intended to cause death, or involved or was intended to involve kidnapping or aggravated sexual abuse. A person need only be working under legal authority during the use of force to be punishable by Section 242. It covers both full and part-time justice system workers and those who do not work for the justice system but who have lawful arrest or other detention powers (for example, private police and correctional officials, deputized persons).

Nonfederal offending officers and their agencies may be civilly liable in state court, or in federal court under 42 U.S.C. §1983. Because §1983 does not cover federal officers, it was established that they may be held personally civilly liable in federal court for unreasonable force or other rights deprivation under a “Bivens Claim” (*Bivens v. Six Unknown Federal Narcotic Agents*, 91 S.Ct. 1999, 1971). Federal government agencies can only be held liable for rights violations under the Federal Tort Claims Act (28 U.S.C. Chapter 171).

Unreasonable fatal and nonfatal violence perpetrated by police against citizens sometimes has been attributed to stress-inducing job factors, most notably life-threats, social isolation, peer pressures, departmental policies (or lack of them), discretionary decision-making pressures, physiological stress, and anticipatory fear in responding to calls. These conditions contribute to what Jerome Skolnick has termed the “policeman’s working personality.” This personality is said to be nurtured on the job and includes the elements of authoritarianism, suspicion, racism, insecurity, hostility, and cynicism. Police are expected to establish authority immediately in a tense situation. They sometimes resort to physical force to achieve that authority.

Police are constantly exposed to danger, so they are likely to become suspicious about those who are not part of the police fraternity. Suspicion and authority, coupled with hostility and insecurity, can easily promote the use of unreasonable force. Role socialization may also partly explain brutality by prison authorities; Phillip Zimbardo demonstrated that even ordinary citizens will develop authoritarian personalities while temporarily in the role of human custodians.

## THE DIRTY HARRY PROBLEM

Police and prison personnel often become cynical about the social value of many citizens with whom they come in contact, thereby promoting the use of certain “techniques of neutralization,” including the “denial of victim” neutralization for brutality (the person had it coming). Further, because the court system is often seen as impotent, an “appeal to higher (justice) loyalties” may be used to help render brutal officer behavior acceptable. Some police and prison personnel believe that bending or breaking the law is acceptable in order to get their job done, and this would include the protection of fellow officers from brutality accusations.

Carl Klockars has termed these tendencies among police the “Dirty Harry Problem” (after the Clint Eastwood movie character). Officers believe that it is acceptable to use “dirty” means to achieve “good ends” (that is, justice), and only “dirty means will work” in attaining those ends. In terms of differential association theory, such attitudes are often transmitted to new officers and assimilated into a shared departmental value system. There may be an excess of definitions favorable to the justification



*Police brutality can be understood in terms of differential association and self-control theories.*

for criminal brutality that have been learned by officers who employ it. Such schooling may encompass various ways of inflicting brutality.

Group socialization, coupled with job stress, then, has generally been seen to be the major explanations behind police brutality. There also may be nonoccupational factors associated with individuals' personalities that provide an additional explanation.

Self-control theory would conceptualize brutality as an attempt by police to gain "revenge without court delays." Self-control theory would argue that brutality contains many elements of low self-control behavior—it provides excitement, thrills, and risks; there are few long-term benefits associated with it; it takes little skill; it results from a low frustration tolerance; and it demonstrates a lack of attachment to the feelings of others. The theory

would also emphasize that situations in which brutality occurs invariably are perceived to have low visibility, thereby decreasing offenders' perceptions of being punished.

For self-control to be supported as an explanation of brutality over occupational differential association, it would have to be demonstrated that pre-employment levels of self-control are lower among officers who ultimately are more likely to use excessive force. This finding would support self-control theory's notion of stability, and demonstrating that assaulting officers also are involved in other occupational deviance would support the theory's notion of versatility.

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differential association; self-control theory; Sutherland, Edwin H.; police corruption; Mollen Commission; Knapp Commission.

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## police corruption

WHEN POLICE officers intentionally misuse their authority for personal aims, it is termed police corruption. It is a problem that has occurred since modern policing evolved, and it is international in scope. While all criminal experts agree that it is an important social problem, there is less agreement about the extent of corruption.

Some individuals see the majority of police as corrupt, while others believe that only a handful of officers engage in corrupt activities. Three reasons limit our ability to determine the extent of police corruption: conceptual factors, methodological issues, and cultural factors.

In conceptual factors, there is great disparity in the ways that experts define police corruption. Some scholars follow strict definitions of corrup-



tion and suggest that any time a police officer violates the rules of her department, corruption has occurred.

The problem is that the rules police are expected to follow are quite extensive. Rulebooks for police departments in major cities are up to one foot thick. There are rules about when to wear a hat, how to get out of a car, how to question suspects, whether to accept a free cup of coffee, among thousands of others. In the end, it is virtually impossible to follow all of the rules all of the time. So, are they committing misconduct when they violate department rules?

At the other end of the continuum are those scholars who define police corruption in rather liberal terms. Members of this camp would allow the police to commit an assortment of transgressions, so long as no one is directly or unfairly harmed by their actions. After all, in most jobs individuals commit what is referred to as occupational deviance. People take longer breaks than they are supposed to; workers take things from work that are supposed to stay at work; sick leave and vacation time are routinely used inappropriately; restaurant workers often take food without paying for it—what is wrong with police officers engaging in similar acts? Thus, some conceptual confusion exists regarding what should be characterized as misconduct and what should be characterized as just a part of the job.

Methodological issues exist that also make it difficult to determine the precise extent of police corruption. It is essentially impossible to study police corruption with traditional research strategies. Researchers have tried to survey police officers regarding their experiences with corruption. These studies have proven to be difficult: Police officers are particularly distrustful of surveys, and when asked about misconduct, honest officers are offended and dishonest officers are not going to be open with researchers. Known as the “Thin Blue Line,” it is difficult for researchers to cross over into the world of policing and get access to their activities, lives, and routines when it comes to police corruption.

Similar problems arise when researchers conduct field studies with police officers. Known as the Hawthorne Effect, officers will alter their behavior in the presence of researchers. Researchers, then, are not able to observe true police work. Rather, they are being presented with a staged production

that will bias any possibility of obtaining an accurate portrayal of life in the streets.

Cultural problems also limit our ability to accurately understand police corruption. Within the United States, cultural variation exists in individuals’ beliefs about appropriate and inappropriate police behavior. Minorities are especially distrusting of the police. Consequently, members of minority groups have been known to routinely call into question all police activities. These cultural issues extend past the boundaries of the United States and exist on an international level. Types of police behavior tolerated in various countries varies significantly. Consider the following:

In Haiti, the wife of a police commissioner of Jacmel hired eight men to kill a 17-year-old boy after the boy littered in her yard.

A survey of households in Bangladesh found the police department was the country’s most corrupt public institution. Three-fourths of respondents interacting with police in the prior year indicated that they had paid bribes to the police.

In Bolivia, a criminal gang committed a series of horrific robberies. Eventually authorities learned that the gang included a colonel and major from the local police department.

In Kenya, students and others protest regularly about the extent of corruption on the Kenyan police force.

In Mexico City, a police officer on a motorcycle pretended that a car hit him in an attempt to extort thousands of dollars from the driver. Two other cops pretended to be civilian witnesses to this incident.

These are just a handful of the cases that represent the enormous number of corruption incidents across the world. While it is difficult to determine the extent of police misconduct, researchers have considered the varieties of misconduct, as well as the causes and consequences of the behavior.

## VARIETIES OF POLICE MISCONDUCT

One of the first police corruption typologies was developed by J. Roebuck and T. Barker in 1974 in an article appearing in *Social Problems*. The authors identified eight different types of corruption including the following: corruption of authority, kickbacks, opportunistic theft, fixes, protection of illegal activities, direct criminal acts, internal pay-offs, and flaking. Corruption of authority is accept-

ance of free or discounted meals, as one example. Note that it is not always seen as corruption, however. Some departments have policies stating that it is wrong for officers to accept free or discounted meals, while others say such activity is entirely appropriate because it builds good relationships between the police and the public. Many business owners support these policies because it allows them an extra layer of protection—nobody will rob an establishment where police are present. Those who say it is wrong worry about the possibility that police would not provide the same degree of public services to stores that did not provide the free or discounted meals. When police officers force individuals to offer the free or discounted services, many agree that police misconduct has occurred.

Kickbacks occur when police officers get reimbursed for referrals they make. Police officers are in a position to make a host of referrals to citizens. Citizens may want to know who to call to have their car towed. Others may want to know who the best attorney or bail bonds agent is. Depending on department rules, it may be entirely appropriate to offer a referral of some sort. It becomes inappropriate when officers make referrals and receive money or some other favor from the party that benefited from the referral. These practices promote dishonesty and undermine a free market economy.

Opportunistic theft occurs when officers take things to keep for themselves, but they did not necessarily plan the theft. An officer can commit all kinds of opportunistic theft from “borrowing” a newspaper on the subway to stealing money from citizens and drugs from offenders. These aren’t planned robberies; officers just take advantage of situations that presented themselves.

A fix occurs when officers accept certain favors or bribes in exchange for decisions that would benefit offenders. Consider a case where a police officer accepts money for not arresting a crack cocaine dealer. Or, consider instances where police officers accept sexual favors for not writing a traffic ticket. These are each examples of fixes. In essence, police accept money, services, sexual favors, or something else in exchange for not enforcing the law.

Protection of illegal activities is a fifth type of corruption described by Roebuck and Barker. This occurs when police offer protection to individuals or groups involved in criminal enterprises. Those often cited as receiving police protection illegally include prostitutes, drug dealers, gangs, and organized

offenders. This type of corruption is doubly problematic because those receiving protection may commit crimes beyond supposedly victimless offenses.

Direct criminal activities are acts that are illegal for everyone to commit. If a police officer robs someone, then a direct criminal activity has occurred. If a police officer uses drugs on the job, then a direct criminal activity has occurred. Perhaps the easiest way to think of it is that these actions involve offenses that could get any individual arrested.

Internal payoffs are a seventh type of police corruption. These occur when police officers buy, sell, or barter certain benefits of their job. They may sell their shift to another officer, or trade vacation time. This is basically misuse of administrative policies.

Finally, flaking, also known as padding, occurs when officers plant or add evidence to cases. Some experts think that this is more common in drug cases than any other type of case. Related flaking are instances where police officers lie during trial. The process of lying during testimony is called “testilying” by New York City police officers. It is justified on the grounds that if the offender is guilty, all measures should be taken to ensure they are found guilty.

Los Angeles Police Officer Mark Furham, who was accused of planting evidence in the O. J. Simpson case once remarked, “if you find a needle mark [on a drug suspect] that looks like three days old, pick the scab. Squeeze it. Looks like serum’s coming, as if it were hours old. That’s not falsifying a report. That’s putting a criminal in jail. That’s being a police officer.”

## CAUSES OF POLICE MISCONDUCT

Researchers at the Home Office in the United Kingdom cite three possible reasons why police corruption occurs: “bad apples” theory, police organizational explanations, and structural explanations. Bad apples theory suggests that just a few officers are generally corrupt, and those few make the whole department look bad. Recent research has discredited this approach, in part, because corruption, when uncovered, is usually widespread in various departments.

Police organizational explanations look at how the organization of police work may contribute to corruption. There is generally no oversight over

police officers in the streets. They are free to do as they wish. They are underpaid, and opportunities to interact with “bad” people are a part of officers’ daily routines. The public is not able to watch over the police so they have an enormous amount of discretion, and misuse is, to some, inevitable.

Structural explanations refer to the fact that some values, norms, and practices of certain cultures and subcultures may promote misconduct. In the United States, it is customary to tip those who help us out. Why not tip a police officer for a job well done? We tip hair dressers, taxi cab drivers, delivery people. The norm (standard rule in our culture) is that tipping is an appropriate way to display our satisfaction with others. As well, cultures that have high levels of political corruption generally have higher levels of police corruption.

### CONSEQUENCES OF CORRUPTION

A number of consequences occur as a result of police misconduct. One consequence has to do with the decreased amount of trust that individuals have in the police as a result of occasional indiscretions by law enforcement officers. When the public hears about a particular officer engaging in inappropriate activities, the image of the profession is tarnished, and public trust is hindered.

A second and related consequence is fear. When the public loses trust in the police, fear ensues. For example, rumors of corrupt officers in Tijuana, Mexico, abound. Imagine being a tourist in Tijuana and seeing a police officer. Are you going to trust that officer? Are your perceptions of trust going to influence your perceptions of safety?

A third consequence has to do with the fact that police corruption potentially lowers the faith that individuals have in the law. If police don’t obey the law, why would ordinary members of society? In effect, those sworn to enforce the law, may actually be criminogenic agents rather than deterrent agents when they commit misdeeds on the job.

It is important to note that the majority of police officers do not engage in illicit activities on the job. The few who do, however, wreak havoc on the profession and society.

### SEE ALSO

police brutality; corruption; Knapp Commission; Mollen Commission; bribery; Mexico; organized crime; consequences of white-collar crime; fear of crime.

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## political assassination

WITH A LONG LEGACY throughout history, political assassination has more recently come under the study of crime, and has been delineated between assassinations of a specific individual person or group, or assassinations of persons targeted by chance but with a political agenda. These two main groups may be distinguished by a dozen typologies, which overlap often or describe escalating phases of a conflict.

Assassinations to get rid of a ruling politician and to destabilize the political situation within a country are widely known in democratic and non-democratic societies. The best known examples are the assassinations of John and Robert Kennedy and of Martin Luther King, Jr., in the United States during the 1960s, or the shooting of Mahatma Gandhi in 1948. Although the moral and sometimes political impact of those assassinations is large, in democracies the political system is seldom changed by such events. Though in dictatorial regimes the elimination of a ruling person may change the regime itself, democracies tend to be able to survive such assassinations as they have proper and accepted rules for succession in place. A recent case of an assassination to change (in the view of the assassin) the course of national politics was the Yitzhak Rabin murder during what was believed to be an Israeli-Palestinian peace process.

Assassinations to start or complete a military coup may be used to overthrow a weak democratic system or to change one dictatorial regime for another. Sometimes it is done by local military forces

alone, but other cases have had heavy involvement from Western intelligence agencies.

Assassinations as a tool of war within a civil war are known in many countries all over the world. After Germany became a republic following its defeat in World War I, a large campaign of political murder was engaged by elements of the extreme right, which claimed the lives of several leading politicians. A starting point for the civil war in El Salvador was the shooting of Archbishop Oscar Romero by a murder squad of the extreme right-wing paramilitary. More recent cases include the shooting of Serbian Prime Minister Zoran Djindjic as part of the fading Yugoslav civil war (allegedly linked to mafia involvement), or the killing of Afghan warlord Ahmed Shah Massoud by a suicide assassin of Taliban or al-Qaeda origin, in a nearly coincident timing with the attacks of September 11, 2001.

Assassinations by separatist groups are a common tool to underline their political goals. Some examples include the bombing of Lord Louis Mountbatten by Catholic separatists from Northern Ireland, or the killings of Indira and Rajiv Gandhi by Sikh and Tamil separatists in India.

Assassinations of political opponents or dissidents by totalitarian regimes in the country or abroad became prevalent especially during the fascist period. Although Benito Mussolini made this part of fascist policy, Adolf Hitler epitomized it during the so-called Roehm-Putsch when he personally ordered and supervised the killing of dissidents within the Nazi party in 1934 (Ernst Roehm, a high-ranking and brutal Nazi official, was killed during this internal purge).

Communist regimes, especially during the Stalinist era employed the same tools; the most famous victim was Leon Trotsky, who was brutally murdered in his Mexican exile. Another example is the killing of opposition leader Benigno Aquino upon his return from exile to the Philippines. An assassination of this type could also happen as a formal death penalty by a court, for example many victims of the Nazi terror were sentenced to death for minor "crimes" by the so-called Volksgerichtshof (Court of the People).

Assassinations of people coming to importance not by their political role, but because they witnessed, by whatever circumstances, an event which might be harmful to the assassins if it would be made public: Usually these cases are hardly de-

tected and fall within conspiracy theories. A famous case is the still unsolved murder of the West German prostitute Rosemarie Nittribitt in 1957, who is believed to have had several lovers within the ranks high officials.

Assassinations of political figures or members of the judiciary by the Sicilian Mafia were commonplace in Italy in the 1970s and 1980s. Not only conspiracy theorists, but others linked the murders of the two Kennedy brothers to the Mafia, citing the rigorous anti-Mafia policy of Robert Kennedy as a possible reason. Organized crime assassinations of politicians for their stand against drug trafficking is a dominant part of politics in countries like Colombia.

Assassinations of civilians of a certain origin, religion or political nomination were common in Lebanon and in Northern Ireland in the 1970s and 1980s. Usually those events prepare for or culminate a civil war, which in some cases is a low-intensity armed conflict. Such assassinations take place regularly on a large scale by Palestinian suicide-bombers. An example of an incident where terror was executed in another country is the slaughter of the Israeli Olympic team in Munich in 1972 by Palestinian terrorists.

Assassinations by resistance groups during an occupation against enemy forces and especially against some of their own people viewed as "traitors," can be seen in the American occupation of Iraq in 2003–04 as a U.S.-approved Iraqi police chief was targeted.

Assassinations by mentally ill persons can target anybody. Whereas the murder of John Lennon only had minor political impact, the shooting of President James Garfield was planned by an insane person without any "reasonable" political intent, but was political by virtue of the victim.

Assassinations of civilians chosen at random to provide a climate of terror and fear in the public mood for internal reasons are much more often employed by right-wing extremists than by left-wing counterparts. Terrible examples were the bombings of the Bologna, Italy, railway station in 1980 or the more recent Oklahoma City bombing in 1998. As with terror against individual representatives within democracies, the long-term effect of such attacks can only be attained if the democracy itself was weak even before the killing took place.

Terror attacks against civilians chosen at random by terrorist groups from abroad were brought

to a new dimension by al-Qaeda during the events of September 11, 2001. Assassinations on such large scale changed not only threat perceptions, but also questioned many traditional approaches to terror and law. Assassinations and terror attacks before were seen only as a problem for the police and the judiciary. After September 11, the distinction between assassins, terror organizations, and rogue states is fading.

Mass murders or even genocide by totalitarian regimes are, in fact, assassinations on a large scale. The 20th century was marked by such monstrosities from the Armenian genocide during World War I to the Holocaust and the killing fields of Cambodia. Although those mass murder actions need far more factors to happen (people, material, preparation) compared to a single assassination, they can be regarded as the culmination of political assassinations.

Political assassinations may have short term impacts like a change of government or regime, but even in stable democracies, where the effect is limited to the replacement of the victim by another democratically legitimated person, they may poison the political climate for years to come.

#### SEE ALSO

elite crime; United Fruit; South America; Central America; Cuba.

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## polyvinyl chlorides

FOR MANY YEARS a component of plastic, polyvinyl chlorides (PVCs) have been used in products ranging from construction materials to chil-

dren's toys, and from mini-blinds to intravenous and blood bags.

Polyvinyl chloride was first discovered in 1835 and was one of the first commercially developed plastics. The white powder is made from 57 percent salt and 43 percent oil. It can be blended with a wide variety of stabilizers, lubricators, softeners, and pigments to make a versatile range of products.

There is increasing evidence that there are hazards associated with this material. One problem is that PVC is partly based on chlorine, which is linked to such highly toxic substances as dioxin. Another problem with PVC is that the additives used in it are frequently toxic. Soft PVC requires the addition of plasticizers, the most common of which are phthalates. One phthalate is DEHP, an additive to make PVC softer and more flexible, which has been found to have adverse effects in laboratory animals. The Food and Drug Administration, in September 2002, recommended limiting exposure to DEHP as much as possible.

#### AGGRAVATED BATTERY

Five Chicago Magnet Wire senior executives were charged with aggravated battery, conspiracy, and reckless conduct in a case in which more than 40 company employees suffered nerve and lung disorders resulting from exposure to hazardous chemicals at the company's Elk Grove Village, Illinois, facility. These chemicals included polyvinyl chlorides. The charges were first dismissed in 1985 by an Illinois state judge. That decision was upheld by a state appellate court, but it finally was reversed by the Illinois Supreme Court in February 1989. The following October, the U.S. Supreme Court refused to hear the five-year-old case, thus letting the conviction stand. The court's decision to not hear the case cleared the way for all state prosecutors to proceed against executives for crimes regarding the health and safety of their employees, an issue which had up to that time been decided differently in different state courts.

In November 2001, an Italian court acquitted former chemical company managers of criminal charges ranging from mass manslaughter to environmental damage. The charges had been brought against the EniChem and Montedison managers three years earlier on behalf of 157 workers who had died of cancer and another 103 who had died of other illnesses between 1965 and 1985. These

deaths were alleged to have occurred because of the workers' exposure to vinyl chloride monomer (VCM) at the Porto Marghera, Italy, chemical complex. Environmental charges resulted from the company's allowing the effluent to pollute the famed Venice Lagoon. The court's ruling to dismiss charges was based on the fact that the workers originally became ill in the 1950s and 1960s, but it was 1973 before the potential dangers of VCM were discovered. VCM is used in the production of PVC. Montedison, in a separate agreement with Italy's environmental ministry and the prime minister's office, agreed to help fund clean up of Porto Marghera and the lagoon.

In July 2000, the European Commission issued a Green Paper with its evaluation of PVC environmental issues. The Green Paper stated that PVC is one of today's most widespread plastics with about 5.5 million tons produced in Europe alone in 1998. Lead, cadmium, and organotins are stabilizers in PVC products which are used to prevent deterioration from heat and light. Lead stabilizers are classified as toxic and carcinogenic; cadmium is classed as harmful, toxic, or highly toxic, carcinogenic, and dangerous to the environment.

The commission, however, asserted there was no assessment at that time of the hazard of these chemicals in PVC. It also asserted that information available indicated these chemicals remain bound in PVC while it is in use; potential damage is during the elimination of the PVC materials. When PVCs are burned, almost all the lead and cadmium remains in the residue.

#### SEE ALSO

Nader, Ralph; Consumer Product Safety Act; unsafe products; workplace deaths.

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## Pontell, Henry N. (1950–)

HENRY N. PONTELL is a modern pioneer in white-collar crime research. His writings have covered all aspects of white-collar crime, from medical fraud to the savings and loan crisis to international issues surrounding white-collar crime. As an undergraduate student, Pontell received the New York State Regents Scholar Incentive Award to pursue his studies in sociology and political science at the State University of New York, Stony Brook (SUNY). In graduate school, he received a State University of New York Graduate Research Fellowship and U.S. Department of Justice Research Fellowship. He also worked as a lecturer and as a research associate in the School of Health Sciences at SUNY. Pontell received his Ph.D. in sociology from SUNY Stony Brook in 1979. His dissertation was titled, "Deterrence and System Capacity: Crime and Punishment in California."

In 1979, Pontell was hired as an assistant professor in the social ecology department at the University of California, Irvine (UCI). He has served in several different capacities at the university, including chair of the Department of Criminology, Law and Society at UCI.

While his research has covered an assortment of topics, his white-collar crime research has been especially illuminating. In the early 1980s, he began publishing several studies on white-collar crime topics: One study examined police chiefs' perceptions of white-collar crime, another examined how flight attendants are victimized on the job, and another examined strategies used to detect and investigate Medicaid fraud. This third study was the groundwork for a plethora of other studies on Medicaid fraud. These studies eventually culminated in *Prescription for Profit*, a book he co-authored with Paul Jesilow and Gilbert Geis.

Pontell's white-collar crime research also focused on the cause of the savings and loan crisis. Along with Kitty Calavita, he conducted the most

comprehensive investigation of the role of white-collar crime in the savings and loan fiasco. One of their articles was reprinted in the *Hearings of the U.S. Senate's Permanent Subcommittee on Investigations*. They also provided written testimony to the U.S. Senate's Subcommittee on Consumer and Regulatory Affairs, Committee on Banking, Housing, and Urban Affairs. With Robert Tillman, Pontell and Calavita published *Big Money Crime*, a book detailing their savings and loan research. In 2001, Pontell received the Albert J. Reiss Jr. Distinguished Scholarship Award from the Crime, Law, and Deviance section of the American Sociological Association for his efforts.

In the same year, to honor his contributions to increasing understanding about white-collar crime, Pontell was the recipient of the Donald R. Cressey Award from the Association of Certified Fraud Examiners. He has remained active in his discipline and his community, including a four-year stint as the public safety commissioner for the city of Irvine, California.

#### SEE ALSO

Geis, Gilbert; Jesilow, Paul; Medicare and Medicaid fraud; healthcare fraud; savings and loan fraud.

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## Ponzi scheme

A **PONZI SCHEME** is an investment fraud in which returns are paid to earlier investors at a great profit entirely out of money paid from a wave of newer investors, who are encouraged to make investments in response to the handsome returns received. Ponzi schemes are similar to pyramid schemes, but differ in that Ponzi schemes are operated by a central company or person, who may or may not be making other false claims about how the money is being invested, and where the returns are

coming from. Ponzi schemes do not necessarily involve a hierarchal structure, as in a pyramid scheme; there is merely one person or company that is collecting money from new participants and using this money to pay off promised returns to earlier participants. Because the Ponzi scheme requires an ever-increasing number of investors to keep going, there always comes a point at which the money coming in is insufficient to pay off the previous wave of investors, and they all lose their money.

The scheme is named after Charles Ponzi, who ran such a scheme in 1919–20. The backdrop of his scheme was international postal reply coupons (IPRCs), which could be redeemed for stamps in other countries. Ponzi realized that by purchasing IPRCs in a country whose currency was weak, he could redeem them for stamps in a country whose currency was strong, making a small profit on the differing exchange rates. He found that he could purchase Spanish IPRCs for a penny and redeem them in the United States for 10 cents. Ponzi thought he could take advantage of differences between U.S. and foreign currencies used to buy and sell international mail coupons.

Ponzi told investors that he could provide a 40 percent return in just 90 days compared with 5 percent annually for savings accounts. After his investors' three-month period was up, they were reimbursed with interest not at the guaranteed 40 percent, but at 50 percent.

The investors gladly reinvested the entire amount, and spread the word that Ponzi was the man with whom to do business. While continuing with his scheme, Ponzi discovered that IPRCs were issued only for the convenience of postal customers who used international mail, therefore only a limited number of coupons were issued each year, not nearly enough to finance an investment system like the one he had in mind.

In fact, the Spanish government issued fewer than \$1 million worth of these coupons. Ponzi received orders that were so huge that there was no possible way for him to purchase enough IPRCs to cover them. So, he "robbed Peter to pay Paul," reimbursing earlier investors with funds taken from later investors.

As Ponzi paid the matured notes held by early investors, word of enormous profits spread through the community, whipping greedy and credulous investors into a frenzy. He had no trouble finding increasing numbers of investors necessary

to keep the operation running smoothly. Happy investors convinced their friends that Ponzi's operation was a safe, easy, and quick way to multiply their savings.

When the swindle was discovered by authorities, Ponzi was exposed through the newspapers. However, people didn't believe the authorities and continued to send money to Ponzi. When the operation was shut down, investors blamed the Massachusetts authorities for victimizing Ponzi and sabotaging their chances of getting their investment back. All told, he took in over \$10 million in less than a year.

Though a few early investors were paid off to make the scheme look legitimate, an investigation found that Ponzi had purchased less than \$50 worth of the international mail coupons. The simplicity and grand scale of his scheme linked Ponzi's name with a particular form of fraud. A swindle of this nature, once a "bubble," is now referred to as a Ponzi scheme. The engine of Ponzi's postal coupon fraud was a simple accounting misclassification. Money paid to investors, described as income, was actually distribution of capital. Although the economics of such schemes are simple, contemporary swindlers conceal this fact with sophisticated marketing.

The classic Ponzi scheme is still popular today and works in the same way. And unlike pyramid schemes, where one's potential gain is measured by the active and conscious practice of participant recruitment, Ponzi schemes attribute their money-making abilities to some elaborate and inventive investment or business process, with the influx of new depositors the result of word-of-mouth only.

There are several other distinctions between Ponzi schemes and a pyramid selling scheme. A requirement of a Ponzi scheme is the promotion of what starts out to be, or appears to be, a real investment opportunity which investors may passively contribute to. The pyramid scheme involves a person making an investment for the right to receive compensation for finding and introducing other participants into the scheme. There is a clear understanding among the participants that the success of the opportunity is dependent upon attracting these additional participants.

#### SEE ALSO

scams; Stavisky, Serge; securities fraud; investment trust fraud; Securities and Exchange Commission.

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## pornography

A CLASSIFICATION of crime peripherally related to white-collar and corporate crime, pornography refers to sexually explicit materials produced to induce sexual arousal in a viewer or reader. Pornography, as an illegal revenue source for enterprises ranging from organized crime to internet entrepreneurs, crosses into white-collar crime with tax evasion, money laundering, corruption, and a variety of frauds in accounting and banking that are spread all over the world.

The regulation of pornography evolved from early obscenity laws originally enacted to protect political and religious views. The concept of suppressing sexual expression in the media became a concern in the 19th century following the invention of photography, and the staging of theatrical performances with sexual themes. Anthony Comstock was among the first moral reformers to call for the suppression of sexual expression. Over the years, the manufacture, distribution, and sale of pornographic materials has been either forbidden or regulated in various jurisdictions, however possession of pornography by an adult in the privacy of one's home is generally legal.

To the extent the manufacture or sale of most pornography is illegal, it is viewed as sensual crime. Whether viewing pornography has harmful effects or not has been debated for decades with passionate arguments, but with little conclusive evidence on either side. A case can be made for or against it depending on the industry perspective, images depicted, or whether pornography affects the viewer's subsequent behavior.



Two government commissions have addressed the issue of harm from pornography, arriving at different conclusions. Formed in 1970 under President Richard M. Nixon, the Commission on Obscenity and Pornography initiated the scientific approach to the issue. Researchers representing mostly behavioral sciences conducted studies under the auspices of a \$2 million grant. Attempts have been made to classify pornography, with the simplest scheme being the three categories used in the 1986 Commission. Class I is adult erotica that may depict images of sexually explicit nudity but not actual intercourse or violence. Class II depicts intercourse, and Class III depicts images of intercourse in conjunction with violence.

The 1970 Commission concluded viewing and the availability of pornography had little measurable effect on the public. Feminists and conservative politicians subsequently challenged its findings. After the early 1970s, the nature and distribution of pornography changed. The 1970 commission examined only popular erotic materials such as *Playboy* and *Penthouse* magazines. By the late 1970s, the number of pornographic publications vastly increased along with the increasing use of videotapes depicting more depraved images.

Rape scenes were and are common, and this is the basis for the feminist argument that pornography encourages violence against women. At the extreme, is the so-called snuff film in which the actress is murdered on camera. Also in the mid-1970s, child pornography became more prevalent. No one doubts child pornography and snuff films are extremely harmful to those involved in production. They remain in the province of organized crime, and though penalties are substantial, profits are high. The appearance of such materials and the content of mainstream pornographic magazines and videos caused many to question whether the 1970 Commission findings still applied.

During the early 1980s, feminists such as Andrea Dworkin and Catharine MacKinnon successfully led crusades against the sale of pornographic images that depict the degradation of women, resulting in city ordinances in Minneapolis, Minnesota. The feminist anti-pornography crusade combined with an unlikely ally of conservative politicians to further question the effect of pornography on the public. To again evaluate the question, the Attorney General's Commission on Pornography was created under President Ronald Reagan

and submitted its conclusions in 1986, contradicting those of the 1970 Commission.

Along with debates over the effects of pornography are legal battles. Those who manufacture and sell pornography seek to have the industry protected by the First Amendment of the Constitution. The hardest part is trying to define something that is as subjective as pornography. On this topic, Supreme Court Justice Potter Stewart stated in 1964 (and is often quoted): "I know it when I see it." The Supreme Court has applied the First Amendment quite broadly. The legal battles over pornography are extensive and complex. Three of the most prominent cases in the 20th century have generally afforded First Amendment protection. In *Roth v. United States* (354 U.S. 476, 1957) the Supreme Court ruled that only materials "utterly without redeeming social importance" do not have First Amendment protection. What constitutes redeeming social importance is debatable and can be minimal.

The Supreme Court in *Stanley v. Georgia* (394 U.S. 557) granted First Amendment protection to individuals to read or watch whatever they want in private. In *Miller v. California* (413 U.S. 15, 1973) the Supreme Court stated material is pornographic that is by law "patently offensive" such that the average person viewing it using "contemporary community standards" would feel it appeals only to "prurient" sexual "interests." In addition to these criteria, the work taken as a whole "lacks serious literary, artistic, political, or scientific value." Once again these are open to interpretation.

While organized crime once controlled virtually all production and sale of pornographic materials, Supreme Court decisions and changes in technology have made the pornography market very accessible. Virtually anyone with a video camera can get into the business to some degree. The production of pornographic videos requires relatively low production costs and a strong market exists regardless of any artistic merits of the film. The change from 8mm films to videotape and VCRs in the late 1970s revolutionized the industry.

The pornography industry is composed of many sizable media distribution companies vying for control of product distribution. Regular video stores often, depending on local ordinances, offer adult videos along with mainstream films (albeit in back rooms). Video is the major market, but adult bookstores, peep shows running short films, or live-

model dancing are common in large cities. More recently, the internet has afforded virtually unlimited access to pornographic materials without any censoring. The use of the internet to display, market, and sell the most debased and prurient materials, has raised new questions of regulating the internet.

#### SEE ALSO

organized crime; Justice, Department of; money laundering; reform and regulation.

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## predatory practices

**PREDATORY PRACTICES** are forms of unfair competition. In consumer markets, they mostly involve exploiting the public's lack of information about products, often financial products such as home loans or credit terms, thereby obtaining unjustifiable fees and unfair contractual conditions. In business markets, predatory practices involve attempts by one company to use its market power or influence to take advantage of a smaller company or companies. Making a large order from a small company and then not making payments so that the supplier is forced into bankruptcy is one example of a predatory practice.

In consumer markets, predatory practices most commonly focus on the attempt to exploit people's lack of information about lending practices, thereby obtaining more money from them. This includes such practices as flipping, which involves causing customers to renegotiate loan details repeatedly, possibly in a short period of time, while charging

high fees on each occasion. Another practice is asset-stripping, which is making loans based on equity in a property rather than the loanee's ability to repay the loan. This is designed to lead to default on behalf of the customer and the transfer of the property (or other asset) to the lending company. Packing involves adding supplementary costs such as credit insurance to a loan, which therefore increases its value without the informed consent of the loanee.

Many of these practices are not in themselves illegal; it is possible and quite common for a lender and loanee to renegotiate the terms of a loan, for example. However, predatory practitioners take advantage of those people unable to provide informed consent. Vulnerable groups include the elderly, those for whom the language of the agreement is not the native language and those with a legal status that prevents them from taking full recourse of the protection of the law.

This last category includes migrant workers who may have documents or agreements that, with or without their knowledge, are not wholly legal. Such people may be forced to meet additional payments to job agents or else required to participate in occupations they would not wish to take or live in conditions they would not have considered suitable. An additional segment of this market is the issuing of loans to people in high risk categories, because of poor credit records or borrowing defaults. Loans made to this group attract very high fees.

Owing to the huge expansion of personal debt in recent years associated with the growth in credit card usage, the Federal Trade Commission has estimated that this practice resulted in loans to the value of \$56 billion in 2000 alone. The expansion of credit card usage in Korea and Japan has already led to massive personal indebtedness for many people who have then become vulnerable to debt collectors who may require them to undertake tasks or jobs they would not wish to undertake.

The growth of the internet and the penetration of e-mail throughout all sections of developed societies has provided opportunities for unscrupulous lenders to identify potential victims at a relatively low cost. People responding to advertisements likely to lead to such practices are added to others matching profiles believed likely to lead to high levels of vulnerability on so-called sucker lists which may be traded among unscrupulous lenders for high prices.



*Airlines have been accused of predatory practices in how they charge tourist versus business customers.*

One difficulty that regulators have faced in tackling predatory practices has been in the lack of adequate definitions of what it is and what scope it has. The growth of communications technology and sophisticated financial instruments in the consumer market as well as industrial markets have together enabled predatory practitioners to continue to innovate new schemes and methods a step ahead of regulators.

In business markets, accusations of predatory practices have been leveled at airlines in the United States and Japanese corporations seeking to undermine the international patent system, among others. Such accusations may result from complaints about tough but essentially fair business practices or may be part of fairly regular cross-border trade diplomacy. Some American commentators, for example, have labeled the practices of competitors from Korea or Taiwan as predatory when they are able to provide goods to the American market at lower costs than domestic competitors are able to achieve.

Complaints against the airline industry focus on the use of hub premiums; large airlines have greater market power at strategic travel centers and may charge competitors extra to use them, especially in the case of low-cost carriers seeking to focus on niche markets. Other complaints focus on the possibility of signaling prices to competitors (via computer systems) to maintain comparable rates on all routes, which again disadvantages many smaller competitors.

The payment of excessive salaries and compensation to executives has also been termed a predatory practice, as has excessive profit-making in a variety of industries, although there is generally no consensus on what constitutes an acceptable level of profit.

#### SEE ALSO

Federal Trade Commission; illegal competition; price-fixing; antitrust; bank fraud.

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## price discrimination

PRICE DISCRIMINATION IS DEFINED as the act of selling the same product to different consumers at different prices even though the cost of supplying the product is the same. Price discrimination is widespread in the economy. Airlines charge lower prices for travelers who book seats well in advance or who are willing to stay over on a Saturday night in order to differentiate between recreational travelers who often have low budgets for vacations and business travelers who have a high willingness to pay for flights. Movie theaters give discounts to students, senior citizens, and matinee viewers. Frequent flyer programs, supermarket membership cards, store coupons and even college tuition financial aid packages are other common examples of price discrimination.

When a firm can set prices such that each individual customer is paying their maximum willingness to pay, this is known as perfect price discrimination or first-degree price discrimination. Under first-degree price discrimination, the customer is left with no consumer surplus, that is no value in excess of the purchase price of the good. Third-degree price discrimination occurs when the

market can be broken up into a several distinct groups each of which faces a different price. Second-degree price discrimination occurs when the firm charges different prices to different consumers depending on the quantity purchased by each consumer. Price discrimination is often confused with predatory pricing. Predatory pricing occurs when a firm charges a price below cost in order to drive rivals from the market with the intention of raising the price again once the competition has been eliminated. Unlike price discrimination, which is usually an acceptable practice, predatory pricing is prohibited by Section 2 of the Sherman Antitrust Act (1890).

### THIRD-DEGREE PRICE DISCRIMINATION

In most cases, economists believe that price discrimination, while it increases firm profits at the expense of some consumers, actually increases societal welfare by allowing the firm to maximize profits while serving a variety of customers. The sale of AIDS drugs in the United States and Africa is an excellent case in point. If forced to sell AIDS drugs to all consumers in the world at the same price, drug manufacturers would likely choose a price that exceeded that which a typical African consumer could afford. By engaging in third-degree price discrimination, a pharmaceutical firm will charge high prices in rich countries but then lower the price to victims in poorer countries expanding the number of patients able to afford treatment. Similarly, book publishers immediately provide access to an author's latest work for those willing to pay the premium for a hardcover edition while later expanding the market to additional readers with the subsequent publication of a paperback.

Economists note that successful price discrimination requires several conditions to be in place. First, the firm or provider must have some degree of market power in order to be able to set prices above the equilibrium price determined in the marketplace. Next, the firm must have the ability to identify those willing to pay a high price for the good from those not willing to pay a premium. This can be accomplished in many ways from geographical pricing (as in the AIDS drug example) or age related pricing (student or senior discounts) to directly collecting information on buyers (direct disclosure of economic information on college financial aid applications.) Finally, the seller must

have way to prevent those who purchase the good at a low price from reselling the good to others with a higher willingness to pay. This can be done through contractual prohibitions or the voiding of warranties following resale. Services tend to be difficult to resell, and high transaction or transportation costs may also reduce resale. While generally legal, price discrimination is prohibited under the Robinson-Patman Act (1936) in cases where there is a substantial likelihood of a significant reduction of competition. This reduction of competition can take two forms. Primary line discrimination occurs when the price discrimination reduces competition in the market of the good itself.

Secondary line discrimination occurs when competition is reduced among the customers of the good so that a favored buyer has a competitive advantage over its rivals in a downstream market. A firm has two primary defenses against a charge of illegal price discrimination. Price discrimination is always legal if it is the direct result of differences in the cost of supplying the good to different customers. Differences in transportation costs are one obvious example, and volume discounts are another if it is truly cheaper to supply the good in larger quantities. Second, price discrimination is legal if the firm is cutting its price to one customer in a legitimate attempt to meet an equally low price of a rival company. In other words, if a competitor offers a low price to one of a company's clients, the company need not lower its price to all of its clients in order to meet to this single challenge.

### PRICE DISCRIMINATION CASES

The economic history and the case law of the United States are full of examples of price discrimination. Most famously, John D. Rockefeller's Standard Oil Company solidified its monopoly hold on the American oil business by demanding that the railroads charge Standard Oil a lower price for transporting its products than those of its consumers. The railroads, who could ill-afford to lose the business of such a large shipper, acquiesced to Rockefeller's request for this type of secondary line discrimination.

The higher transportation costs faced by these rival companies left them at a competitive disadvantage compared to Standard Oil, and ultimately either led to their acquisition by Rockefeller or simply drove them out of business entirely. By

1900, the Standard Oil Trust “had obtained complete mastery over the oil industry, controlling 90 percent of the business of producing, shipping, refining, and selling petroleum and its products, and thus was able to restrain and monopolize all interstate commerce in those products” (*Standard Oil Company of New Jersey et al. vs. United States*, 1911). While Standard Oil’s actions occurred before such practices were declared illegal, it is important to note that a charge of discriminatory pricing can be leveled either against the seller or against the buyer, as would have been done in this particular case.

Other cases are less well-known but equally instructive. In *Utah Pie v. Continental Baking* (1967), a small, locally owned baker in Salt Lake City, filed suit against its three major competitors in the rapidly expanding frozen pie market, Continental Baking, Pet Milk, and Carnation. While Utah Pie only operated in the Salt Lake City area, the other three firms had nationwide operations. The three national companies charged lower wholesale prices for their pies in the Salt Lake City area than in other areas of the country and often charged prices below cost. The court ruled that this type of primary line price discrimination was anticompetitive with the intent to drive Utah Pie from the market, although dissenting justices argued that the market structure in Salt Lake City following the actions of the three firms was more competitive than before their price wars. Many observers note that basic economic models would show that markets where four major competitors compete should have lower prices than markets where only three competitors exist. Price differentials between Salt Lake City and other markets may, therefore, be due to effective competition rather than anti-competitive behavior. Perhaps the court should have asked why the three national brands charged so much in other cities rather than why they charged so little in Utah.

*Matsushita Electric v. Zenith Radio* (1986) combines the concepts of predatory pricing and price discrimination. Zenith argued that, from 1960 to 1985, a cartel of Japanese consumer electronics manufacturers conspired to sell their products in the United States at below cost in order to drive American manufacturers from the market. These predatory pricing schemes were made possible by the higher prices the cartel charged to domestic consumers in the Japanese market. While agreeing that Japanese firms did engage in primary line price discrimination by charging higher prices to Japanese

consumers than American consumers, the court found it unreasonable that a cartel of companies would be content to suffer losses for 25 years in order to attain a monopoly position that even after 25 years they were far from achieving. Thus, the court ruled that it was unlikely that predatory pricing had occurred and that the price discrimination was not illegal since it did not lead to a reduction in competition.

In *FTC v. Morton Salt* (1948), the government examined Morton’s practice of offering discounts of up to 20 percent on sales to customers purchasing large quantities of salt. The court stated that quantity discounts are only legal to the extent that quantity sales lower costs to the seller. While the discounts were potentially available to any customer, in reality they were available only to a select few customers who could buy in quantity. Therefore, this secondary line price discrimination reduced the ability of small businesses to compete with giant firms.

Similarly, in *United States v. Borden Company* (1962), the Borden company was unable to prove that the costs of providing milk to the stores in the two large Chicago grocery chains, Jewel and A&P, were lower than the cost of providing milk to independent stores, and therefore their secondary line price discrimination was declared illegal. While the average cost of supplying milk was lower in the large chains, the court ruled that “proof by average” was an inadequate defense since it failed to recognize instances where the cost of providing milk to a single particular independent store could be far lower than the cost of providing milk to a single chain store. Borden came out on the right side of the law in a later case regarding milk prices.

In the 1970s, Great Atlantic solicited bids from milk producers to provide an in-house milk brand for its A&P stores. Borden submitted the winning bid and offered to provide milk to A&P at a substantial discount over the price it charged to other firms. In *Great Atlantic & Pacific Tea v. FTC* (1979), the court ruled that since Borden was simply bidding for a contract, it could not possibly be guilty of illegal price discrimination. Borden was clearly acting to meet competition. While the Robinson-Patman Act declares it to be illegal for a firm to use its market power to secure a discriminatory price from a supplier, since Borden was not guilty of illegal price discrimination, Great Atlantic could also not be guilty of securing a discriminatory price. In *Stan-*

*Standard Oil Company v. FTC* (1951), Standard Oil sold gasoline to four large “jobbers” in the Detroit area at a price substantially below the price at which it sold its gasoline to regular retailers in the area. The difference in price was more than the cost differential to Standard Oil. Standard argued that it only charged a lower price to these jobbers in order to retain their business in the face of competition from other oil firms. Again, the court granted that a firm may make price changes in order to meet competition for a major customer without simultaneously cutting its prices to all its other customers.

Government action against price discrimination has become increasingly rare as it is being seen more as special interest legislation designed to protect small businesses from more efficient larger firms.

#### SEE ALSO

price fixing; antitrust; Sherman Antitrust Act; Robinson-Patman Act; Standard Oil; Rockefeller, John D.; robber barons; predatory practices.

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## price fixing

PRICE FIXING REFERS to any usually unlawful practice in which competing corporations join together and agree to set or maintain an artificially high price, for commodities or services, to maximize profits. It may take place at either the wholesale or retail level and, although it need not involve every competitor in a particular market, it usually involves most of the competitors. According to the Antitrust Division of the U.S. Department of Justice, it is not necessary that the competitors agree to charge exactly the same price, or that every competitor in a given industry join the conspiracy. Price fixing can take many forms including, for example, establishing or adhering to price discounts, holding prices firm, eliminating or reducing discounts,

adopting a standard formula for computing prices, maintaining certain price differentials between different types, sizes, or quantities of products, adhering to a minimum fee or price schedule, and fixing credit terms.

A number of price-fixing cases, however, do not involve explicit agreements, but rather takes the form of parallel pricing in which there is a tacit understanding that if one or a few companies raise their prices, the others will adjust their own prices accordingly. It is normally difficult for a court to successfully identify agreements in parallel pricing cases just by applying the common judicial definitions of agreement. Some economists estimate that parallel pricing, which is mostly beyond the reach of law, may cost consumers over \$100 million annually.

#### THE PRICE-FIXING DEBATE

There has been an academic debate about whether price-fixing agreements should be outlawed. Some economists in the libertarian tradition argue that price-fixing cartels are inherently unstable and unlikely to be effective in maintaining artificially high prices. Successful price collusion would be of negligible proportions, even without antitrust legislation. They also employ a “natural rights” theory of property and defend a right to fix prices as part of a person’s natural right to freely use her property. They argue that any interference in the freedom to contract is a violation of natural rights. The benefit most often claimed for price fixing is a method for firms to reduce uncertainty and thereby to reduce the cost of investment and marketing mistakes.

Most economists and law professors, however, remain almost unanimous in condemning all price fixing as a harmful practice. They provide empirical evidence which suggests that price-fixing agreements can, in fact, be quite long-lived. They note that it is always possible that the members of an industry might succeed in getting together and fixing a price. By raising prices and restricting supply, price fixing makes commodities and services unavailable to some consumers and unnecessarily expensive for others.

A price-fixing agreement, therefore, distorts the functioning of the marketplace by causing resources to be switched from production of the affected product to other less highly valued uses. Elimination of pricing uncertainty, as claimed by



*Price fixing suggests a conspiracy or collusion among competing companies to set an artificially high price.*

the libertarian economists, can easily be achieved by the use of legally permissible information sharing among members of an industry. In this view, an effective way to deter price fixing is strong legislative and enforcement systems with severe penalties for price fixing.

Much evidence suggests that price fixing has been extremely common across a broad range of industries. Edwin H. Sutherland identified at least six different methods for fixing prices and found evidence of numerous suits alleging this activity. One recent study concludes that the illegal activity of price fixing was costing U.S. consumers an estimated \$60 billion annually during the 1980s. Over the years, price-fixing conspiracies have been uncovered for virtually every imaginable product or service, including oil, sugar, beer, infant formula, steel wheels, cardboard cartons, industrial chemicals, long-distance phone companies, and airlines.

One of the most celebrated price-fixing cases involved heavy electrical equipment manufacturers, including General Electric and Westinghouse, who conspired over a period of decades to fix prices for their products. Fairly substantial fines were imposed on the companies, and a number of mid-level executives, who denied the charges, went to jail briefly (for less than a month).

## OTHER CONSPIRACIES

Price fixing conspiracies are, in fact, not limited to industrial sales. Price fixing, in one form or another, often occurs in real estate fees, doctors' fees, lawyers' fees, tax accountants' fees, and even university tuition fees and financial-aid packages. Until recently, it was common practice for local bar associations to publish schedules of minimum fees and to punish attorneys who charged less. Because they have the authority to control admission to the practice of law, such associations actually have a much greater power to fix their price schedules than do business associations.

The American Bar Association used to hold that the "habitual charging of fees less than those established in suggested or recommended minimum fee schedules, or the charging of such a fee without proper justification, may be evidence of unethical conduct." A lawyer, therefore, could be disciplined or disbarred for failing to charge clients a high enough price. This brought the application of the antitrust laws to the legal profession.

In the United States, the Sherman Act of 1890 prohibits explicit price fixing that happens via communication and specific agreement between corporations. Violation of the Sherman Act is a felony punishable by a fine of up to \$10 million for corporations, and a fine of up to \$350,000 or three years' imprisonment (or both) for individuals. Price fixing is subject to criminal prosecution by the Antitrust Division of the U.S. Department of Justice, with the assistance of the Federal Bureau of Investigation (FBI) in some cases. In addition to receiving a criminal sentence, a corporation or individual convicted of a Sherman Act violation may be ordered to make restitution to the victims for all overcharges. Victims of price-fixing conspiracies also may seek civil recovery of up to three times the amount of damages suffered.

As a weapon against price fixing, however, the Sherman Antitrust Act was rarely used to crack down on price-fixing conspiracies. Until recent years, a hands-off approach was found in investigations and prosecutions of price-fixing cases. Throughout the world, broad deregulation based on *laissez-faire* (unrestricted) capitalism had begun to make many governments care little about price-fixing. In 1991, in recognition of the widespread violation of the price-fixing prohibition, Congress moved to reform the law to make the practice more

difficult. For example, vertical price fixing, in which some manufacturers attempt to dictate retail price levels and lock out discounters, became vulnerable to lawsuits as a result of this reform. Maximum fines grew from \$50,000 in 1955 to a virtually unlimited amount by 1991.

Despite this reform, the Justice Department lost many battles in its war on price fixing cartels. While more than 90 percent of the cases wind up with plea agreements, the department has only a mixed record in cases that are tried. Among the antitrust indictments filed from 1992 to 1997 that went to trial, for example, there were four convictions and 15 acquittals. At the Antitrust Division, meanwhile, a new corporate leniency program, granting significant incentives for early cooperation, was adopted in August 1993. The new policy made amnesty automatic if the company came in before an investigation began, and permitted broad amnesty afterward to the first company to offer assistance.

#### SLIM CHANCES

Price-fixing cases pursued by the Justice Department represent only a small portion of the actual amount of price fixing in U.S. industry. The potential profits are too attractive for many business executives, and the chances of getting caught are slim. Price fixing cases have proved difficult to establish in court. The likelihood of escaping conviction, if caught, is great because of two factors: 1) the deals are made in secret and masked by apparently legal activity; and 2) the government's antitrust budget is very small. For those few convictions, they were typically resolved with fines rather than prison sentences.

Similar examples of leniency for price fixing can be found in many other countries. Unlike other criminal cases, executives in price fixing cases are often respected by the community. Executives in most price-fixing cases are generously compensated by their companies, and thus can afford to hire the best criminal lawyers. Some jurors have trouble understanding why price fixing should be a crime.

Since price fixing poses a broad threat to U.S. business and consumers, the U.S. government has been developing a more vigorous approach to price-fixing enforcement since the late 1990s. The Justice Department has successfully prosecuted regional, national, and international price-fixing conspiracies affecting construction, agricultural products, manu-

facturing, service industries, consumer products, and many other sectors of economy. Many of these prosecutions resulted from information uncovered by members of the general public who reported the information to the Antitrust Division.

During four fiscal years from 1997 to 2000, the Antitrust Division collected \$1.7 billion in fines for price fixing. In the same period, more than 75 years of imprisonment have been imposed on price fixing and other antitrust offenders, with more than 30 defendants receiving jail sentences of one year or longer. Following the United States, governments in Europe and Asia are also beginning to combat price fixing more seriously than before. More countries that historically have not been troubled by price fixing are toughening their laws.

#### SEE ALSO

elite crime; capitalism; free enterprise; Sherman Antitrust Act; price discrimination; predatory practices.

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## prisoners

IN THE ANNALS of white-collar crime, the ethics of medical experimentation on prisoners has been a contested issue since the early 20th century, when the anti-vivisectionist movement began protesting human subject experimentation, and in particular, experimentation on those populations deemed vul-



nerable to manipulation or coercion, such as prisoners, children, and the mentally ill. The central concern underlying the movement's protest was whether these populations could offer voluntary consent to experiments, consent having been an ethical principle long accepted by most doctors as a requirement for human experimentation. Although much experimentation on prison populations has been regulated out of existence since then, the ethical question the anti-vivisectionists posed remains a contested issue.

Through the first half of the century, experimentation on prisoners was somewhat belittled by the scientific community in the United States. Despite that, several infamous exceptions have been documented. In 1906, Dr. Richard Strong experimented on a group of Philippine prisoners, exposing them to the cholera virus and, mistakenly, to the bubonic plague, when a bottle of the plague serum was accidentally substituted for the cholera serum. Thirteen prisoners died as a result. Strong, later a professor at Harvard University, continued his experiments with the Philippine prisoners six years later, when he exposed a group of subjects to beriberi. More prisoners died from these experiments. In payment for their participation, prisoners were offered supplies of cigars and cigarettes.

In Mississippi, in 1915, Dr. Joseph Goldberger attempted to discern the cause of pellagra, a disease of unknown origins that caused disfigurement and often death in its victims. The cause of pellagra was in doubt, but Goldberger thought it originated from a lack of adequate protein in the diet. In order to prove this, Goldberger created the necessary dietary conditions among a group of convicts at Rankin Farm prison by feeding the subjects a diet comprised strictly of starch. The subjects soon began to experience the traditional symptoms of pellagra, including dizziness, pain, and skin lesions. The men, some of whom became severely ill, received pardons for their participation in the experiment.

Following the advent of World War II, however, prison populations began to be seen by scientists as legitimate, and even especially valuable, subjects for medical experimentation. Generally, the populations were relatively healthy, unlike patients in hospitals, and willing in many cases to volunteer for dangerous and even lethal experiments in exchange for small amounts of money or for letters written on their behalf to parole boards. Prisoners also had,

for scientists, the advantage of being easily regulated.

Experiments ranging from injections of animal blood to exposure to dengue fever and gonorrhoea were performed on "volunteer" prison populations. In a famous case in Illinois, over 400 inmates of Stateville Penitentiary were infected with malaria. Prisoners were bitten by infected mosquitoes and experienced all of the symptoms of malaria, including vomiting, unconsciousness, and fever. Often more lethal, however, were the countless untested medicines given to the prisoners.

## THE NUREMBERG CODE

The public generally supported these efforts which were seen as patriotic, given that American soldiers were dying overseas in vast numbers, sometimes of the diseases that were being studied in the prisons. After the war, when experimentation on prisoners might have been expected to decrease, a huge boom in experimentation on inmates occurred, lasting through the early 1970s. Ironically, the first international code of ethics on the subject of human-subject experimentation, the Nuremberg Code, had just been adopted. The code was a response to the Nazi doctors' trials in Nuremberg, Germany, during which the horrific experimentation on inmates of concentration camps and mental hospitals was revealed. In fact, during the trial, several Nazi doctors defended themselves by citing experiments conducted by American doctors on prison populations, such as the experiments on the Philippine prisoners in the early part of the century.

The Nuremberg Code established 10 ethical standards necessary for humane experimentation on human subjects, including the principle that the human subject "should have legal capacity to give consent ... exercise free power of choice, without the element of force ... constraint or coercion." This principle seemed to rule out experimentation on prisoners, who could not be said to be free of constraint or coercion.

In the United States, however, the Nuremberg Code was virtually ignored. Prisoners participated in experiments involving everything from malaria and cancer to skin creams and toothpaste. Some of the more dangerous experiments included the injection of live cancer cells into inmates of the Ohio prison system, and radiation exposure to the testicles of inmates in Oregon and Washington. Years

later, survivors of the radiation experiments reported prostate cancer, vision loss, pain, rashes, and other problems that were traced to the radiation.

One of the more reprehensible research programs, begun by Dr. Austin Stough, involved the removal of plasma from prisoners to sell to pharmaceutical companies. Stough pioneered a process that allowed donors to contribute more frequently by separating the donated plasma from the red blood cells which were then re-injected into the donor's body. Indifference to the prisoners' health resulted in poorly trained staff, contaminated supplies, and dirty rooms for withdrawing the plasma. Some prisoners were mistakenly re-injected with the wrong type of blood, a potentially fatal mistake. Other prisoners succumbed to viral hepatitis and sickened or died as a result. Stough's operations were eventually shut down as the deaths were publicized, but not before he made millions of dollars from his work.

#### AWARENESS AND REGULATION

Public opinion on prisoner experimentation was gradually shifting, helped along by the publication in 1973 of Jessica Mitford's indictment of the penal system, *Kind and Usual Punishment*. Mitford's damning chapter on prisoner experimentation, "Cheaper than Chimpanzees" compared the excesses of the U.S. research programs to the Nazi medical experiments revealed at the Nuremberg Trials. Newspapers and government agencies alike began looking seriously at the practice of prisoner experimentation, and, in 1974, a commission was created to study research conducted on human subjects and to identify ethical principles that should govern such experimentation.

In 1976, the director of the Bureau of Prisons, Norman Carlson, banned all medical research on federal prisoners. State prison systems also began shutting down research programs in their prisons. By the 1980s, most of the experimentation on inmates had ceased. New federal regulations were adopted in 1981 to protect prisoners and children as research subjects. The rules provided for review boards to insure that subjects were not exposed to unnecessary risks and to restrict all "unnecessary physical and mental suffering." The new rules also dealt with the issue of informed consent, though not with the strictness of the Nuremberg Code. Instead, the rules required only that the researcher

make an effort to "minimize the possibility of coercion or undue influence." Specific to the issue of prisoners, the new regulations required that in cases dealing with prison experimentation, at least one member of the review board should be a prisoner. Researchers were forbidden to offer incentives such as improved food, living conditions, or other enticements that would unduly influence a prisoner to risk participating in an experiment. The rules also mandated that the research must have some beneficial or relevant application to the prison population. Researchers now needed a valid reason for choosing prisoners as subjects, other than their ready availability.

With these restrictions in place, the lure of prison populations as fertile ground for experimentation and profiteering effectively ended. While experimentation on prisoners remains legal in some cases, it is severely limited in its application in the United States.

#### SEE ALSO

World War II; medical malpractice; ethics; research fraud.

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## Procter & Gamble

PROCTER & GAMBLE (P&G) has been accused since 1980 of associating with the devil. Problems over their man-in-the-moon and stars trademark surfaced in that year when people began calling the company to ask if it was owned by the followers of

Reverend Sun Myung Moon. The company responded to this assault by writing to news organizations in the Midwest, the origin of most of the telephone calls.

The emphasis of the rumors changed from Moon's church to Satanism, and December 1981 brought the company 1,152 questions/comments on the subject. Tales spread of Procter & Gamble's owner admitting on television that he had traded his soul to the devil in return for the company's success, and the company president announcing on the Phil Donahue Show that 10 percent of their earnings went to a Satanic religion.

The rumors did not die despite a second mailing, this time to the West Coast, statements by Procter & Gamble executives on television shows, and clarifications of the fact that P&G is a corporation and thus profits go to shareholders, not any individual who could send them to a religious group. In the spring of 1982, P&G reportedly was contacted 12,000 times per month regarding its relationship with the devil. Because of indications that some clergy were urging their congregations to boycott P&G products, the corporation sent letters to clergy. These letters contained support for Procter & Gamble from well-known clerics including Reverend Jerry Falwell, leader of the church-based Moral Majority.

By June 1982, more than 15,000 inquiries were made regarding the trademark, and in July, P&G, which produces over 70 household products including Tide, Folgers Coffee, and Oil of Olay, filed lawsuits in an attempt to control these widespread rumors which could potentially cost the company customers, sales, and loss of profit. Most of these defendants sold products, including Amway and Shaklee, which compete with P&G's products. The suits brought publicity and perhaps some understanding by the public because inquiries to P&G dropped by half. By 1990, Satan-related queries were again spiking and the corporation filed its 13th suit charging defendants with spreading false and malicious statements.

In 1995, P&G filed its 15th suit, this time against a Texas Amway distributor who repeated the rumor in a voicemail available to other distributors for a fee. The basis for this suit was that it violated the Lanham Act, a federal law protecting companies from unfair competition in many forms, including misleading representations in commercial advertising. In 1995, P&G named Michigan-based

Amway, not just its distributors, for the first time in a suit filed in the U.S. District Court in Utah.

In August 2000, the Denver, Colorado, federal appeals court dismissed the Utah suit against Amway but revived previously dismissed cases against some of its distributors. In 2001, the federal appeals court in New Orleans, Louisiana, revived the suit against Amway based on the 1970 federal Racketeer Influenced and Corrupt Organizations Act (RICO), and sent it back to Texas for retrial. In January 2003, a federal appeals panel in Utah, then a U.S. District judge in Texas, separately affirmed the lower courts' dismissals of P&G's suits against Amway. At that time, the Utah and Texas suits against Amway distributors were still unsettled. P&G won some suits, including gaining a 1991 \$75,000 settlement from a Kansas couple who were Amway distributors.

## CORPORATE HISTORY

Procter & Gamble was founded in Cincinnati, Ohio, in 1837 by brothers-in-law William Procter, a candle maker, and James Gamble, a soap maker. The company expanded, and by the mid 1850s it was shipping to other areas of the country by river and railway. Shipping containers were identified with trademarks because many dockworkers were illiterate at that time. Company tradition has it that Procter & Gamble's boxes were first marked with a simple cross on their Star brand candles.

Later the cross was changed to a circled star, and then William Procter elaborated on the trademark making it 13 stars (for the original 13 colonies) and the man in the moon. Because trademarks were the main mode of company identification, when another soap maker began using a very similar emblem in 1875, P&G sued to have him stop. P&G won the suit and registered the symbol in 1882 with the U.S. Patent Office. The familiar bearded man-in-the-moon and stars, slightly changed since 1882, was developed by sculptor and artist Ernest Bruce Haswell.

The International Directory of Company Histories states, "In 1985, the company reluctantly removed the logo from product packages. The logo began to reappear on some packages in the early 1990s, and the company continued to use the trademark on corporate stationery and on its building." In 1991, P&G removed from its trademark the swirls which, when viewed in a mirror, appear to

render “666,” a number which many people associate with the devil.

#### SEE ALSO

patent infringement; trademark infringement; unfair trade practices; marketing fraud.

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## product liability

**PRODUCT LIABILITY** refers to the legal responsibility of manufacturers, wholesalers, and retailers to compensate buyers and users who have suffered damages or injuries as a result of defective goods. A more detailed definition is provided by Patricia Pepin:

“A breach of the standard of care in the manufacturing, bottling, assembling, distributing, or inspecting of products, which causes foreseeable harm to the ultimate consumer, where there has been no possibility of intermediate examination, will give rise to liability.” Products subject to liability include a wide range of consumer goods such as food, drugs, home appliances, automobiles, tobacco, and medical devices.

According to the National Commission on Product Safety, over 20 million Americans have suffered injuries as a result of unsafe consumer products; 110,000 have been permanently disabled and over 30,000 have died. It comes as little surprise,

therefore, that product liability cases constitute one of the principal areas of civil law.

As with the general concepts of torts, negligence, and liability, product liability laws have been shaped by shifting political and social attitudes toward the consumer society and the obligations of corporations. In the 19th and early 20th centuries, legal discourse centered on an individualist ethic that tended to absolve corporations of responsibility for their products. There were few cases of successful actions against corporations for defective products. In the mid- to late 20th century, however, notions of corporate liability expanded and judges and lawmakers gradually began to implement broader legal definitions that held businesses liable for a range of offenses related to the goods they produced and sold. Recent years, however, have seen somewhat of a backlash as judges and politicians have gradually decreased the scope of product liability law in response to concerted tort reform lobbies initiated by industry and conservatives.

## HISTORY OF LIABILITY

The common law origins of the concept of liability date from 1763 in England and 1791 in the United States. In the British and American legal tradition, the concept of legal liability was hedged by strict boundaries in the 18th and 19th centuries. An ethic of individualism was dominant in legal thinking which held that only individuals involved in direct contractual agreements, or who were victims of personally inflicted damage, were eligible to sue on the basis of liability or negligence. Until the early 20th century, Valerie P. Hans writes, “a variety of legal rules and societal and judicial attitudes supported the ethic of individual responsibility.”

This was very much in tune with the dominant ideology of free-market capitalism, that is, a belief in unrestrained economic growth, free trade, and a minimal role for the state and courts in business activities. The product liability of manufacturers was thus severely restricted since the sale of a good was regarded solely as a commercial transaction between seller and buyer. Legal historians argue that this restricted definition of liability with regard to products was one of the most uniform and strictly followed laws in both England and America.

For much of the 19th and 20th centuries, courts followed the precedents of the 1842 English case *Winterbottom v. Wright*. *Winterbottom*, a coach

driver, was severely injured when the poorly built vehicle he was driving collapsed. The coach had been bought by the postmaster general from the manufacturer, Wright. Winterbottom worked for a company which was contracted by the postmaster general to provide horses and drivers for its coaches. In other words, he was not employed directly by the company that bought the defective product. Winterbottom's case against Wright was dismissed on the basis that the seller of the product cannot be sued, even for demonstrable negligence, by a party with whom no contractual agreement existed. In legal terms, Winterbottom was not "in privity" with Wright.

Justification for the dismissal of the suit provides a clear illustration of legal thinking on corporate responsibility at the time. Justice Baron Alderson expressed: "If we were to hold that [Winterbottom] could sue in such a case, there is no point at which actions would stop. The only safe rule is to confine the right to recover to those who enter into the contract: if we go one step beyond that, there is no reason why we should not go fifty." Chief Baron Lord Abinger seconded this line of thinking: "We ought not to permit a doubt to rest upon this subject, for our doing so might be the means of letting in upon us an infinity of actions ... Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, of which I can see no limit, would ensue." In the words of Denis W. Stearns, "with the Winterbottom decision, the doors of the courthouse were locked to any one who did not possess the key of 'privity.'"

## 20TH CENTURY

In the 20th century, however, broader and more detailed definitions of tort law expanded notions of product liability. This largely resulted from shifting social and political beliefs regarding the responsibility of businesses to their consumers, especially in an era in which a mass, consumer economy was emerging. One of the first significant court cases in this larger social development occurred in 1916 in *MacPherson v. Buick Motor Company* decided in the New York Court of Appeals. A man was injured because a wooden wheel collapsed and he successfully sued the manufacturer. Up to this time, only the dealer was held liable in such cases of product-related injury, not the manufacturer.

Even with this precedent-setting case, the possibility of winning suits against manufacturers remained small although there were a number of important cases in the food industry. Yet notions of liability gradually expanded as the century progressed. In *Escola v. Coca Cola Bottling Company of Fresno* in 1944, Gladys Escola, a worker in a California restaurant, was badly injured when a coke bottle exploded. She won a jury verdict that was later affirmed by the Supreme Court. One of the Supreme Court judges dealt at length with why an expanded concept of liability was necessary in a modern, complex society with a consumer economy based on mass-produced goods.

Throughout the first half of the 20th century, plaintiffs could base their case for product liability damages on two legal doctrines: negligence or breach of warranty. Negligence requires the plaintiff to demonstrate that a manufacturer, seller, or wholesaler of the product was responsible for exercising reasonable care in the manufacturing or retail process and failed to perform that duty, resulting in injuries to the plaintiff. The plaintiff, however, must show that a company had a duty to exercise reasonable care and that it was the failure to exercise this care that led to the injury. Negligence cases, therefore, require substantial evidence to be provided by the plaintiff.

Breach of warranty claims are governed by contract law, specifically Article 2 of the federal Uniform Commercial Code which all states have followed. The law assumes that manufacturers and sellers provide a formal or informal promise about the quality, type, safety, and performance of a product which constitutes a type of contract between maker or seller and buyer. If the product does not live up to the promise of the "warranty" and causes injury, a plaintiff may make a claim for damages on this basis. Both doctrines are complex, vary somewhat by state and continue to be used today in product liability cases.

It was in the food industry that a third and more expanded concept of product liability first arose in the early 1900s. Strict liability is defined as liability for injuries caused by defective and unreasonably safe products. To establish strict liability, the plaintiff must only prove that the product was defective and that the product defect led to the injury. Strict liability originated in a particular kind of warranty claim that developed through a series of cases involving food products. In 1905, crusading journalist

Upton Sinclair published *The Jungle*, an explosive exposé of unsanitary practices in the meatpacking industry which sparked the first federal food product inspection acts in 1906. Sinclair's shocking report also touched off a heated debate on food manufacturer liability in the courts. By the World War I period, a number of cases against food manufacturers argued successfully that the manufacturer and retailer of food has a particular responsibility to consumers, known as a "special implied warranty."

Historically, this notion only applied to the immediate purchaser of food. In the wake of the scandals in the meatpacking industry, courts soon accepted the argument that the implied warranty was associated with the product itself. Consequently, all persons injured, not just the buyer of the product, could launch suits. Furthermore, it would not be necessary to prove that the food maker had been negligent in preparing the food; sufficient proof of negligence was provided by the fact that the product was defective.

## LANDMARK CASE

This evolving concept of strict liability was confined to food products and gradually extended on a case to case basis until the 1960s. In 1963, a landmark case in the California Supreme Court altered the legal landscape of products liability. In *Greenman v. Yuba Power Products, Inc.* the presiding judges once again expanded the concept of product liability by arguing, in the words of Justice Robert J. Traynor, "that the liability is not one governed by the law of contract warranties but by the law of strict liability in tort." In the years after this decision, all states adopted some form of the doctrine of strict liability which reflected a generalized sentiment among the wider population that corporations should be more responsible to consumers. Furthermore, both the federal government and states established various agencies to regulate the manufacture and sale of products in this period.

From the 1960s to the 1980s, product liability cases dominated the headlines. Cases for damages based on negligence, breach of warranty and strict liability were brought against the most powerful American corporations. Vietnam veterans suffering from the chemical defoliant, Agent Orange, launched suits in the 1970s and settled out of court in 1985 for \$200 million. The Ford Motor Com-

pany lost several key cases in relation to deadly design defects in its popular Pinto model in the late 1970s. Asbestos manufacturers, who have already paid hundreds of millions in damages, still face over 100,000 cases. Significant cases were also brought against products that were particularly harmful to women such as contraceptive devices and silicone breast implants. Dow-Corning's Dalkon Shield, an intrauterine device intended to prevent pregnancy not only failed to work properly (110,000 users became pregnant). It was also found to cause miscarriages, stillbirths, children with birth defects, and pelvic inflammatory disease. Eighteen women died as a result of using the product. Nevertheless, the company spent millions in successful defenses; only in 1992 was a woman awarded \$43,000 in a case against Dow Corning. Class action suits were then launched by thousands of women, some of whom settled out of court for \$200 million.

Despite multimillion dollar awards for product liability, empirical studies have revealed that product liability cases can still be quite difficult to prove by plaintiffs. Large companies have shown that they are willing to spend years in court at great cost to defend themselves which may deter potential claimants.

The limited use of jury trials and the reduction of the power of juries, judicial revisions of jury awards, and caps on "pain and suffering" awards have made product liability litigation a protracted, expensive, and risky course of action. As a result of recent tort reforms, moreover, many states now protect retailers from strict liability; plaintiffs must prove the much more difficult case of negligence to recover damages from the retailer. Corporate reorganization under bankruptcy laws has also allowed companies facing suits to limit liability claims.

In the 21st century, potential sources of tort litigation related to products are diverse and extensive. New technologies are particularly open to legal claims, a process reinforced by substantial pressures from economic interests, social movements, and environmental groups. Products based on scientific advances in genetics and biotechnology, such as genetically engineered foods, have the potential to bring both substantial benefits and harm to economic, social and environmental health, and therefore will likely be highly contested in the courts and legislatures. As in the past, product liability law will certainly be shaped by a complex interplay of social, political, economic, and legal forces.

## SEE ALSO

consumer deaths; Ford Pinto; Dalkon Shield; Dow Chemical; unsafe products; corporate criminal liability.

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## prosecution

WHITE-COLLAR AND corporate crime cases may be prosecuted one of four ways—through criminal prosecutions, civil prosecutions, *qui tam* lawsuits, or administrative hearings. The prosecution stage refers to the strategies used to determine whether offenders are culpable. Tied into the prosecutions are the sanctions to be administered to those who are found guilty or liable.

### CRIMINAL PROSECUTIONS

In the past, criminal prosecutions of white-collar crime cases were rare. However, more currently, a growing number of white-collar and corporate crime cases are being prosecuted by criminal justice officials. While most of these prosecutions are done at the federal level, some are done by local prosecutors. Regardless of where criminal prosecutions occur, a number of issues arise that must be addressed by prosecutors in white-collar crime

cases. In *Crime in the Home Health Care Field* (2003), Brian K. Payne addresses 10 problems that routinely arise in home health care fraud prosecutions: proof problems, witness problems, record chasing, complexity, insufficient statutes, minor losses, offender sympathy, time, victim bias, and funding. These problems can also be seen as occurring in other white-collar crime cases.

Proof problems refer to the fact that criminal prosecutors have an uphill battle proving beyond a reasonable doubt that white-collar offenders are culpable for their actions. First, they must prove that a crime occurred. Second, they must prove that the offender was the one who committed the act. Third, criminal prosecutors must prove that the offender intended to commit the actions. Finally, the prosecutor must dispute any defenses put forth by the defense team.

Witness problems also arise in these cases. On one level, there may simply be no witnesses available. Most individuals do not know it when they have been victimized by a white-collar or a corporate offender. On another level, witnesses may have personal relationships with the defendants, thereby decreasing their desire to cooperate with prosecutors who are seen as the enemy.

Record chasing is another problem that arises. The typical white-collar crime case will require prosecutors to review complex files and evidence. These cases are not the kind highlighted on the evening television shows. They require a great deal of patience, fortitude, and knowledge about different kinds of occupations. In conducting these record chases, a great deal of time and resources must be dedicated to the case.

Most white-collar and corporate crime cases are quite complex. When an individual holds a gun to someone's head and steals her money, it is clear that a crime has been committed. When an individual loses another person's investments, it is not always clear whether a crime has been committed, or simply bad business transactions. Other white-collar crimes are equally complex. When a doctor provides certain services and bills Medicaid for those services, all doctors may not necessarily agree on the utility of those services. It becomes quite complex to determine whether transgressions occurred.

Insufficient statutes are another problem. In many cases, criminal laws may not exist prohibiting certain violations. Computer crimes, for example, were not crimes until recently. Sending viruses,

spam, and other problematic e-mails were crimes in just a handful of states in 2003. Prosecutors have gone after contractors who committed fraud with burglary charges (that is, breaking and entering with the intent to commit a crime) because their fraud statutes were flawed.

Another problem that surfaces is one of minor losses. Many white-collar crime cases in and of themselves may actually be “small potatoes.” Consider an mechanic who charges customers \$10 more than she should for services. Even if the mechanic did this to 100 people, the crimes do not usually amount to a felony because they would be separate misdemeanors, or violations, depending the state’s codes. In order for prosecutors to take on the cases, large losses must be involved.

Offender sympathy is another problem. In particular, judges, the jury, and some prosecutors may sympathize with offenders. Some judges are able to relate to white-collar offenders, but cannot relate to crack dealers, burglars, or other street offenders. Juries also understand some of the neutralizations offered by white-collar offenders.

They tend to believe that all doctors write badly, therefore the pharmacist could not read the writing. They tend to agree that the government does not reimburse fairly, therefore it is okay if individuals steal from the government every now and then. They tend to see white-collar offenders as upstanding members of their community who are not harmful or violent offenders.

The problem of time refers to the fact that white-collar and corporate crime cases can take years to resolve. With the resources to hire strong defense teams and the already long paper chase, these cases can drag on for years. As political officials, prosecutors are judged based on their win/loss record. Too many losses or unending cases could result in a prosecutor losing his job, and dismantling a political future. Consequently, some prosecutors may avoid these difficult, time-consuming cases.

Victim bias occurs when the public tends to be sympathetic to white-collar and corporate offenders, but a similar level of sympathy does not exist for victims. Some individuals see white-collar crime victims as somewhat aloof, unintelligent individuals who deserved what they got. Others see them as money hungry, especially if victims are seeking legal redress in civil court. Thus, judges and juries may discount the words of victims in favor of the words

or testimony of offenders, with whom they can relate socially and intellectually.

Funding is a final problem that comes up in white-collar crime cases. These cases can be quite time-consuming and resource intensive. Most of the criminal justice system budget has historically been dedicated to handling drug offenses and street offenses. More recently, budgets have been increased to battle terrorism; this means that less resources are available for white-collar crime prosecutions.

## CIVIL PROSECUTIONS

Civil prosecutions are substantively and pragmatically different from criminal prosecutions. Generally, civil prosecutions are known as lawsuits. In white-collar crime cases, lawsuits could be filed either by the government or the victim. The party filing the lawsuit is known as the plaintiff. Plaintiffs may prefer civil prosecutions over criminal prosecutions for a number of reasons. These reasons include concerns about proof, evidentiary factors, and penalty recoupment.

In terms of proof, the level of proof needed in civil cases is lower than what is needed in criminal prosecutions. In civil prosecutions, the level is generally what is known as “beyond a preponderance of evidence” while in criminal cases the proof level is “beyond a reasonable doubt.” The preponderance of evidence standard is basically a “more likely than not” standard while the beyond a reasonable doubt standard approaches virtual certainty. It is easier for prosecutors and plaintiffs to prove beyond a preponderance of evidence than beyond a reasonable doubt.

Evidentiary factors also make civil prosecutions especially advantageous. For example, offenders do not have the Fifth Amendment privilege against self-incrimination in civil proceedings. This means that defendants can be forced to testify in civil cases. In addition, because civil prosecutions can occur after criminal prosecutions, prosecutors are afforded access to a great deal of evidence that may have already been presented in a criminal case.

As an example, consider the O.J. Simpson case. While not a white-collar crime case, it is illustrative of the importance of lower proof and increased evidence. Simpson was accused of killing his former wife, Nicole Brown Simpson, and her friend, Ron Goldman. He was acquitted in a criminal trial that



caught the attention of America. Shortly thereafter, Goldman's father filed a civil lawsuit against Simpson. With the lower level of proof, and the fact that the attorneys were able to force Simpson to testify on his behalf, Simpson was found liable in the civil case.

Civil lawsuits are also advantageous in the kinds of penalties that can be assessed. In white-collar crime cases in particular, large monetary penalties can be assessed against offenders. These penalties are usually referred to as damages. Some states allow for what are called "treble damages." Treble damages refer to penalties that triple the amount of the profit that the offender obtained from the crime.

Punitive damages are also permitted in civil cases. Punitive damages are monetary awards, sometimes issued by juries and sometimes by judges, that the defendant is ordered to pay the plaintiff. These damages are designed to punish the offender and are justified by the Supreme Court on deterrence grounds. In effect, the Supreme Court, time and time again, has said that large punitive damage awards can be levied against organizations in order to make sure that organization, as well as other organizations, refrain from similar misconduct.

While there may be certain intuitive appeal to justifying punitive damages on deterrence ideals, in reality research suggests that punitive damages do nothing to meet deterrence ideals. In order for a punishment to be a deterrent, three criteria must be met. First, the punishment must be certain. If a company knows that it will be punished for wrongdoing, then theoretically it should be less likely to engage in wrongdoing. Second, the punishment must be just enough so that it is worse than the pleasure (profit) that the company would get from misconduct. Third, the punishment should be swift.

According to Stevens and Payne (1998), four problems exist in justifying punitive damages on deterrence ideals. First, the penalties are not certain; rather they are better characterized by their arbitrariness. This is especially the case with corporate and white-collar crime prosecutions. There is a high degree of uncertainty in detection and punishment. Second, the penalties are often either not severe enough or too severe. Consider environmental laws as examples of penalties that are too lenient.

It is common to hear of companies committing these offenses because it is cheaper to break the law

than it is to develop mechanisms that would protect the environment. As far as penalties that are too stiff, large damages could actually cause some businesses to close. When the business closes, people are out of work and may then do things that are worse than the original offense. Rather than deterring crime, punitive damages may actually lead to more crime. Third, the penalties are rarely swift, especially for those cases in which large penalties are awarded. In those cases, attorneys usually file appeals which slow the case down tremendously. The Exxon Valdez incident occurred in the late 1980s, causing great destruction at the time. As of 2003, various aspects of the case were still being appealed.

A fourth problem with punitive damages in corporate misconduct cases is that they present the public with an unrealistic view of the civil justice process. Many likely recall the case in which a woman was awarded millions of dollars because she spilled hot coffee on herself. Individuals hear of cases such as this and may assume that the vast majority of lawsuits are equally questionable. Most don't realize that the award in this case was reduced significantly, and it usually is in other cases as well.

While there are problems with justifying punitive damages on deterrence ideals, civil prosecutions remain an integral and important part of the response to corporate and white-collar misconduct.

## QUI TAM SUITS

Another important prosecutorial tool in the response to corporate misconduct is the *qui tam* lawsuit. In a *qui tam* suit, a third party who is not necessarily directly involved in the corporate wrongdoing files the lawsuit. These are also known as whistleblower lawsuits because the individual who files this type of lawsuit is often a whistleblower from within the company. In these cases, the whistleblower is awarded a portion of the punitive damages and the government attorneys serve as the plaintiff's attorneys. *Qui tam* suits have been especially common in healthcare fraud cases.

## ADMINISTRATIVE HEARINGS

Administrative proceedings are also used as a tool to adjudicate corporate misconduct. Hundreds of federal and state agencies exist whose sole responsibility is to oversee a particular industry's activities. All industries have rules and regulations they must

follow, the violation of which may not necessarily be a crime in the legal sense of the word. Consider the Environmental Protection Agency (EPA). Companies are expected to abide by certain rules to protect the environment. Auditors and inspectors will routinely review the company's files and practices to see if any adjustments are made. If the company is violating regulations (regulatory codes), an administrative proceeding may be initiated to determine how to get the company to stop its practices. Compliance is generally the goal of these proceedings.

Note also that virtually every occupation has a governing board that helps to police members of that occupation. Lawyers are members of the state bar. If they commit certain acts, administrative proceedings could be initiated. Doctors are members of the medical bar. If they commit harmful acts, administrative proceedings could be initiated against them. Of course, administrative proceedings are generally seen as less serious than the other kinds of prosecutions.

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Green, Mark; Giuliani, Rudolph; Exxon *Valdez*; Environmental Protection Agency.

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## prostitution

PROSTITUTION HAS BEEN called the oldest profession, and while there is some truth to this statement, how prostitution or sex work is culturally and legally defined varies from one culture to another and over time. The word, prostitute, originates in Latin and means "up front" or "to expose."

This referred to the early Roman female prostitutes who were not required to cover their faces like other women. However, this was not considered a plus, but rather a sort of public shaming, even though prostitutes were free from male domination or patriarchy.

### MALE CULTURE

Usually, Roman prostitutes were slaves who were owned and controlled through the brothels. However, other prostitutes were also performers who operated freely in selling their services. Additionally, males were also prostitutes in ancient Rome. Although free from state regulation in Rome, both male and female prostitutes were under the control of the dominant wealthy and politically powerful male culture.

In ancient Greece, several classes of prostitutes existed including the lowest, the brothel prostitutes; second, the street prostitutes; third, the *aluetrides*, the dancers or performers who are equivalent today to pornography workers, massage parlor workers, and nude dancers. The *aluetrides* were dancers, acrobats, and musicians and were hired to perform at orgies and other social events. They were the next-to-the-highest class of prostitute.

The highest class of prostitute was the *hetaera*, the Greek courtesan prostitute or cultivated companion who associated with the most powerful men of Greece. They were well read, had very proper social graces, and were supposedly very beautiful women who were showered with gifts. However, the *hetaera* also had a number of other skills that she sold, and was engaged in prostitution as a sideline.

From the 4th century through the Reformation, there was some degree of tolerance for prostitution in Western society. Mary Magdalene became a reformed prostitute after her relationship with Jesus, and this redeemed her in the eyes of others. Similarly, many other prostitutes became holy women and saints. In the ancient Near East, India, and southeast Asia, temple prostitution was considered a religious duty for women. Similarly, during medieval England as well as in 19th-century America, becoming a prostitute provided more social and economic freedom and less oppression than doing other kinds of women's work, such as being a servant or textile worker, and even more freedom than being a wife subject to the total control of the husband.

## FREEDOM AND STIGMA

Freedom from a husband did not always translate into freedom from social stigma or legal repercussions. For example, in England in 1822, the English Vagrancy Act was passed and was used to control the movements of poor street prostitutes who were actually referred to as “common women.” Then in 1864, 1866, and 1869, the Contagious Diseases Act was passed in England stating that it was the prostitutes who were spreading sexually transmitted diseases, thus creating the discretionary power of police to arrest any woman thought to have a sexually transmitted disease. The attitude that she was the root of the problem rather than her customer, was prominent in English law until 1985.

Throughout England and other European countries, as conservative religious and cultural attitudes spread, prostitution became even more likely to be banned or criminalized. Many cities attempted to eliminate prostitution, or to socially control women by labeling economically independent women as prostitutes as they moved about in public space. For example, in 1566, the Pope banned all prostitutes from Rome but withdrew the proclamation when approximately 25,000 people prepared to leave the city. But generally speaking, across time and place, the free common women or poor women have been controlled by being socially constructed as prostitutes even if they weren’t, through criminal legislation, while male customers often remained less seriously punished.

Clearly, this method of control was used to limit ordinary women’s movement in public space. For example, in Western Europe as well as during the settling of the western United States, brothels or houses of prostitution were often licensed and protected by law enforcement, while women selling sex for money on the streets was defined as criminal and disallowed. In western America, public displays of sexuality were viewed as distasteful and keeping such behavior hidden from public view within the brothel was much preferred. Additionally, the head of the brothel, or madam, often had much political clout in the community and preferred not to have substantial competition from the streetwalker.

However, both in medieval England as well as early western America, women who were sexually active outside of marriage, even if not for pay, were socially constructed as prostitutes. Moreover, sometimes women’s movement in public space at

particular times was constructed as “vagrancy” or prostitution and thus subject to social control. These social processes provided a method of controlling women’s sexuality and prohibiting women’s full participation in open society, often characterized as both patriarchal and misogynistic (an ideology promoting hatred of women).

## THE MANN ACT

For example, in antebellum St. Louis, Missouri, the idea was promoted that street women corrupted the middle class morals of innocent men by coercing them into illicit sexual acts. Similarly, in 1908, the United States signed an international treaty agreeing to end the slave trade in white women. Nations were required to pass and implement domestic legislation in response to agreeing to specific international treaties or conventions. In response, then, the White Slave Traffic Act or the Mann Act was passed in 1910.

Generally, the law stated that it was illegal to transport women across state lines for “immoral purposes.” While the intent of the law may have been to control forced transportation of women and coerced prostitution, the law was misused to punish a variety of perceived moral issues, such as sexual activities between unmarried couples who traveled across state lines. Additionally, it was aimed at African-American men who were dating white women, as such behavior was considered a usurpation of the “black man’s place” and an infringement upon white male privilege. However, the Mann Act was also used to target real criminals, mostly gangsters, or con men, and occasionally prostitutes who crossed state lines to do business.

The effect of such laws aimed at controlling crime often have unanticipated effects. One such effect of the Mann Act was the victimization of innocent women, and another was the creation of an entire blackmailing industry aimed at the men who crossed the state lines with a non-marital partner for a secret liaison. It wasn’t until 1986 that Congress changed the wording of the Mann Act and eliminated the requirement that federal judges define what “immoral purpose” meant.

Prostitution in urban colonial America was a “fringe phenomena” until about 1820, and in large cities most prostitutes served sailors and men involved in the waterfront marketplace. However, prostitution also thrived in the rural west in the

19th-century mining towns where many men traveled to make their fortune in gold or silver.

## NEW YORK CITY

Timothy Gilfoyle's historiography of New York City prostitution clearly demonstrates that prostitution has been an accepted and normative part of America's history, and provided pathways to wealth for a variety of New York realtors and their families who gleaned profits based on land ownership of the brothels run by a variety of notable Madams all over the city during the 19th century.

Even politicians owned brothels in the 19th century and many madams became quite rich from sex work business. In the 1820s, approximately 200 brothels existed in New York City while, by the end of the Civil War in 1865, there were over 600 brothels in the City. These were located in various geographic areas from the middle-class East Side to Broadway to the wealthier West Side, near local male-only colleges and universities where students abounded, near hotels where businessmen were staying, and the poorer areas of The Five Points and Water Street, the area known for serving sailors and other travelers.

During the 1830s, prostitution in the New York City Five Points area was publicly acted out in the streets. Also, prostitution was commonly interracial prior to the 1830s in New York City with sex workers and customers doing a great deal of mixing among both the higher-paid brothel prostitutes and the poorer salon and cellar prostitutes. African-Americans enjoyed a great deal of economic and political autonomy in both licit and illicit economies prior to the 1830s. Also during the 19th century, lower-class prostitutes were not fortunate enough to have the luxury of a brothel, but rather performed sex work in the upper or lower floors of liquor stores and dance saloons. Many even took advantage of the new ferry system by selling sex on or near the ferry.

## THE SANGER STUDY

The *History of Prostitution*, based upon interviews with 2,000 prostitutes in 1859 is considered the world's first authoritative, scientific study of prostitution. William Sanger's study contains a variety of important findings that have been replicated even in the 21st century with regard to prostitution. His in-

terviews reveal that these women believed that the following factors led to their involvement in prostitution: harsh treatment by parents; parental death; being seduced into false promises of marriage and/or being deserted by their paramour; having no other means of subsistence; being forced into prostitution; or being a drug addict.

While Sanger's work is notable, his work, and substantial work since then, reveals that only among street prostitutes, that is, those who are most likely to end up in jail are such traumatic backgrounds common. Sanger reports that the average female remained a street prostitute for approximately four years during the middle of the 19th century. He found that many women street prostitutes were new immigrants who had often been swindled or criminally victimized by former immigrants who merely repeated the cycle of their own initial victimization on newer immigrants. As has been true for hundreds of years, most women immigrants who became street prostitutes came to the United States in order to improve their condition in life, but many spent their last bit of money to get to America, and thus were forced to choose to engage in sex work to survive after their arrival. Half of the women involved in prostitution in 1859 were married. But many women reported that they had been deserted by their husbands, abused by their husbands, or had husbands who were alcoholics.

Almost half the 2,000 institutionalized prostitutes Sanger interviewed had children, but about half of those children were born before they became prostitutes, while the others were born as the result of involvement in prostitution. Few of these children actually lived with their mothers; most lived with other relatives, including the father, in institutions or in adoptive homes.

Similarly, in more modern times, two-thirds of sex workers arrested in Manhattan in 1984 and 1990 had children, many of whom lived with them. In the 20th and early 21st centuries, street-level sex workers are more likely to be high school dropouts with a history of drug abuse, beginning in adolescence before or in conjunction with participation in prostitution. Female street prostitutes report dependency on drugs with use including heroin, cocaine, and marijuana. Street sex workers are also more likely to be recipients of government subsistence (welfare).

These patterns are replicated among male street prostitutes. Male sex workers are often labeled as

hustlers, apparently a less demeaning label. However, like their female counterparts, male street sex workers are often drug addicts or alcoholics, report a history of dysfunctional families including a history of substance abuse. These males are often high school dropouts, have few vocational skills, and were also physically or sexually abused as children. While some research reflects that male hustlers are coerced into prostitution or engage in prostitution to survive, other work indicates that hustlers report that engaging in sex work is a choice based upon making money.

### CALL GIRLS

The modern call girl often has some college education and provides from five hours of services to overnight services that range from emotional intimacy and conversation to sexual acts. Her services are usually purchased by wealthy white or Asian males. Conversely, street sex workers are more likely to provide less time to clients who are more representative of the general population in terms of race, and more likely to be middle class.

Call girls today engage in sex work within the private space of their home or the client's home, unlike the sex work of street prostitutes who engage in their work in public spaces like cars or hotel rooms. Interestingly, both groups sometimes report long-term commercial relationships with regular clients anywhere from five to 30 years. Today, most prostitutes are not street sex workers, but it is the street worker who is most likely to be violently victimized and arrested by police.

Additionally, sex workers in the United States are not the most frequent source of the spread of HIV-Aids, as they are in many third world nations. However, just as women prostitutes in the 19th century were victimized in brothel riots in New York City, when brothels were attacked by local men under the influence of alcohol who were envious of the economic success of the brothels, street prostitutes today are often very often victimized by robbery or violence usually perpetrated by their customers.

While Sanger's 19th-century research was predominantly focused on street prostitutes who were adults, other work reveals that both in the 19th century and in modern times, young girls and adolescents are also involved in sex work, some voluntarily for reasons of economic freedom or

simply excitement and adventure, while others have been forced into sex work, sometimes by their own families.

International sex trafficking by force, deceit, or coercion is a multimillion-dollar industry mostly serving Western wealthy males with third world women and girls in the role of the sex worker. Sometimes, this global trade also involves organized crime syndicates. Most customers remain male and, generally, in the United States approximately 16 to 18 percent of men report getting at least one service from a prostitute over their life course. Finally, it is street-level sex workers who are more likely to be users of intravenous drugs, and who are also more likely to have a childhood history of sexual abuse or physical abuse. Many teen runaways who leave home as the result of a family history of sexual or physical abuse end up the street, and to survive engage in prostitution.

### REGULATION

While much sex work remains criminalized throughout the world, it is legal and highly regulated within 10 counties in Nevada where brothels are licensed by the state. In these counties, it is mostly female sex workers who are mandated to get weekly and monthly health exams certifying that they are free of sexually transmitted diseases.

Taxable profits are at about \$40 million a year from 35 licensed Nevada brothels. However, Nevada sex workers are often treated like inmates as their personal movements are quite restricted by law, limiting the benefits that could be gained from more liberal forms of legalization. Moreover, the hierarchy of the brothel business is being taken over by men who treat the women with less respect and dignity than the former madam owners.

Across the globe, prostitution was recently legalized in the Netherlands in 2000 partially in order to provide sex workers with employee benefits including health and pension plans, and to ensure lower rates of sexually transmitted diseases. In some parts of Germany, prostitution is also legal. While there is a growing movement around the world in which sex workers are organizing for a variety of workers rights as well as the decriminalization of their profession, they appear more successful in garnering public and political support for decriminalization in the Netherlands than in the United States. Public attitudes are more favorable to

decriminalization in the Netherlands and where prostitution is viewed in less punitive moral terms than here in America. However, prostitution is also the marketplace mechanism for the growing global trade in human trafficking.

Most victims are women and girls but both adult males and male children are also exploited. Often, this involves kidnapping and sometimes involves government cooperation in trafficking women and girls from underdeveloped countries into Western nations. Deception or kidnapping is often used to coerce these women into sex work. The number of trafficked persons is estimated to be in the range of at least 200,000. The illegal industry provides profit to organized crime in the range of more than \$10 billion annually. In 2000, the United Nations adopted the Protocol to Prevent, Suppress and Punish Trafficking in persons as a part of a supplement to the recent Convention Against Transnational Organized Crime.

Although more than 120 nations have signed the protocol, 40 nations must also legally ratify it in order to become international law. Also in 2000, the U.S. Congress passed the Victims of Trafficking and Violence Protection Act that increases penalties for traffickers and improves protections for victims. It includes protection from victimization for consensual prostitutes as well, and thus conforms to the United Nations protocol.

#### SEE ALSO

19th-century regulation; organized crime; Asia; United States; human trafficking.

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## Public Citizen Health Research Group

IN 1971, CONSUMER advocate Ralph Nader founded Public Citizen, a national nonprofit group designed to protect democracy and to keep consumer health, safety, and financial interests before Congress, the executive branch, and the courts. The Health Research Group (PCHRG) was established as a branch of Public Citizen to promote "research-based, system-wide changes in health care policy" and to provide "oversight concerning drugs, medical devices, doctors and hospitals and occupational health." In practice, PCHRG's efforts to protect the public involve making sure that government, the health profession, drug and device manufacturers, and employers remain aware of threats to human health. In addition, PCHRG vigorously pursues any necessary changes on health-related activities, including calling for investigations and criminal charges whenever harmful or illegal practices are suspected. In order to maintain its objective integrity, PCHRG receives no funding from the government or from corporations.

Throughout its history the Public Citizen Research Health Group has been successful in identifying major threats to the health of Americans. In 1976, the organization effectively petitioned the Food and Drug Administration (FDA) to ban the use of chloroform in various toothpastes and cough medicines after it was identified as a cause of cancer. In 1978, PCHRG discovered that the airline industry was failing to provide adequate seating for non-smokers. The following year, PCHRG led a lobby against the use of a DDT spray that was used to kill Japanese beetles in the passenger sections of airplanes. In 1979, PCHRG finally succeeded in its efforts to force the Environmental Protection



Ralph Nader's Public Citizen Health Research Group keeps tabs on a variety of healthcare dangers, and has had notable success in identifying medical malpractice in its *Questionable Doctors* series.

Agency (EPA) to prohibit the use of DBCP, which was known to cause male sterility.

In the following decade, PCHRG helped to convince the U.S. Congress to pass the Superfund law that funded cleanup of toxic waste sites. In 1981, PCHRG published *Pills That Don't Work*, which became a classic guide to consumers and a thorn in the side of drug manufacturers. This was followed two years later with *Over The Counter Pills That Don't Work*.

A three-year battle by PCHRG resulted in labels on aspirin bottles warning parents and other caretakers of the dangers of Reye's Syndrome in children, and a two-year campaign against tobacco products produced warning labels on chewing tobacco and snuff in 1986. PCHRG's efforts to make the workplace safer for Americans led to Occupational Safety and Health Administrator (OSHA) warnings against the industrial use of cancer-causing ethylene oxide in 1988 and the identification of

250 work sites in which workers had been exposed to hazardous chemicals.

In 1991, the PCHRG published the first issue of 6,836 *Questionable Doctors*, a compilation of information on doctors who had been taken to task by the federal and states governments. It was updated two years later with 10,289 *Questionable Doctors*. The list was again updated in 1998 as 16,638 *Questionable Doctors*. Charges against the various doctors include overcharging, falsifying records, insurance fraud, sexual misconduct, practicing without a license, professional misconduct, incompetence, negligence, drug and alcohol abuse, misprescribing or over prescribing medications, and criminal convictions.

When criminal or negligent actions on the part of drug manufacturers are suspected, PCHRG can be relentless in its efforts to protect the public. For example, PCHRG called for Health and Human Services (HHS) to insist that Abbot Laboratories be

found criminally liable for withholding information about the diet drug Meridia, which has been linked to at least eight deaths and to various birth defects. PCHRG also prodded HHS to investigate Schering-Plough over the possibility that the company intentionally distributed asthma drug inhalers that lacked the active ingredients necessary to protect the lives and health of asthma sufferers.

PCHRG also insisted that the FDA recall a clot-busting drug called Abbokinase because it may have been tainted. Any time that drug companies or product manufacturers have been found guilty of criminal wrongdoing, PCHRG continues to keep a watchful eye on their activities. For instance, PCHRG continues to monitor Warner Lambert, a company, which has been involved in 64 recalls of products since 1990. Even though the company pleaded guilty to criminally withholding information about its "sloppy manufacturing practices" from the FDA, the recalls have continued. PCHRG has also been instrumental in pushing for a criminal investigation into Smith, Kline, French for neglecting to report adverse reactions to the drug selacryn. PCHRG played an active role in gathering evidence for the criminal prosecution against the Upjohn Company, which manufactured the drug Halcion, after it was revealed that two of the company's long-term studies contained fraudulent or misrepresented data. Eli Lilly has also been continuously monitored since the company suppressed data about the drug Oraflex, including the number of deaths and injuries that resulted from use of the drug.

Other campaigns by PCHRG include a demand for a "Do not use" warning on a new statin drug called Crestor that has been linked to kidney disease and muscle damage, and a sustained effort to convince the federal government to investigate unethical research being conducted by medical students. In October 2003, PCHRG announced that a possible lift on the ban against silicone gel breast implants was reckless, and followed it up with a warning against the antidepressant Serzone that had been linked to several deaths and injuries.

The deregulation of the dietary supplement and herbicide industries resulted in a renewed call by PCHRG for governmental oversight into these substances that are readily available to consumers with little knowledge of potential toxicities. PCHRG maintains a web site ([www.citizen.org](http://www.citizen.org)) that provides up-to-date information on health-related alerts to

assist consumers in identifying potential health hazards and issues periodic announcements about health-related issues.

#### SEE ALSO

medical malpractice; healthcare fraud; pharmaceutical industry; Environmental Protection Agency; Food and Drug Administration.

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## public corruption

PUBLIC corruption does not have a single definition in the literature. The meaning of public corruption differs across individuals and academic disciplines. For instance, in criminal law public corruption seems to be confined to the act of bribery. In other disciplines, most scholars have taken bribery as the paradigm for a corrupt act and broadened the definition to include a variety of illegal acts. Public corruption is sometime viewed as rent-seeking activities, and some other time as the violation of a public official's duty of faith towards her community.

Most often, public corruption will take place when a public official is offered a payoff in exchange for a favorable decision. By "public officials" we mean any individual who is either appointed, hired, elected, or working for the service of her constituency. Hence public corruption can take place at the federal, state, local levels.

Public corruption can also be defined as acts of nepotism where promotions are based on personal affiliations and not on merit; it can finally be defined as misappropriations of public funds for personal gain and usage.



It is worth pointing out that some scholars have restricted the definition of public corruption to an act of bribery only, but have broadened the definition of bribery to encompass a variety of corrupt behaviors that falls outside the traditional bribery arena. For example, bribery, in this case, is defined to include payoffs to gain access to public goods, to gain access to the use of public physical or financial assets, to be allowed to engage in illegal trade in goods banned for security or health reasons, in money laundering, or to be able to influence the judicial process.

Essential characteristics of public corruption are generally the following: first, two or more parties that include a public official act in mutual agreement; second their decisions violate the law. Third they illegally benefit from the benefit and finally they try to conceal their behavior. Basically, the process can be decomposed into the following parts: a public official, the actual favor provided by the official, the payoff gained by the official, and the payoff gained by the recipient of the act.

The definitions and characteristics mentioned so far seem to suggest that public corruption requires the presence of at least two parties. It should be pointed out that this does not need to always be the case. Indeed the public official can engage in auto-corruption. Though difficult to define, auto-corruption encompasses a situation in which an official acts both as an offeror and a decision-maker and make use of his position to gain benefits to which he was not entitled.

There are many types of public corruption: Indeed the Federal Bureau of Investigation (FBI) defines five major categories of corruption. They are the legislative, regulatory, contractual, judicial, and law enforcement corruptions. Law enforcement corruption has to do with any attempt to bribe law officers or any corrupt behavior of the latter. Examples of such corruption are bribery of law enforcement officials to prevent enforcement of drug laws; other examples include unconstitutional (police) searches and seizures, the provision of false testimony, and the submission of false crime reports. There is legislative corruption when a legislator is paid a bribe to promote a piece of legislation.

Likewise judicial corruption occurs when a judge is paid a bribe for a favorable ruling in a judicial proceeding. Also, there is regulatory corruption when regulatory inspectors are paid bribes to overlook violations of regulatory codes. And finally

kickbacks associated with public contracts are an example of contractual corruption.

## CURBING CORRUPTION

Many efforts have been undertaken to curb and eliminate public corruption. In the United States, the Foreign Corrupt Practices Act (FCPA) was enacted by Congress in 1977 in an effort to criminalize transnational bribe payments of foreign officials by U.S. companies and individuals. By doing so, the United States stood as the only nation in the world to punish its companies or citizens engaged in bribery abroad. Since other countries did not adopt this rule, it was clear that U.S. firms were placed at a disadvantage in international markets. Congress thus asked the president to encourage U.S. trading partners to adopt anti-corruption measures similar to the FCPA. Three important institutions that are mostly composed of trading partners adopted such anti-corruption laws. They are the Organization of Economic Cooperation and Development (OECD), the Council of Europe, and the Organization of American States (OAS).

Founded on April 30, 1948 and based in Washington, D.C., the OAS is comprised of 35 nations. In 1996, as a result of negotiations by the United States, the Inter-American Convention Against Corruption (IACAC) was adopted and sent to country members for signature and ratification. The IACAC was ratified by 21 countries, including the United States. The IACAC provisions clearly specified that an act of public corruption has occurred whenever: 1) there is the solicitation or acceptance by the government official of any article of monetary value or other benefit in exchange for an act pertaining to his functions; 2) there is an act or omission in the performance of his duties for the purpose of illicitly obtaining benefits for himself or a third party. It is thus clear that the IACAC provisions make use of the traditional definition of corruption, but also condemn the misuse of authority for personal gain, even if there is no other party involved.

The OECD was founded on December 14, 1960 and is based in Paris, France. In 2003, the OECD was composed of 30 member nations that are the leading exporters in the world economy. The organization is dedicated to fostering economic growth and development and is therefore a platform for anti-corruption measures. In 1997, the 29 mem-

bers along with 5 nonmember nations signed the OECD Convention (Convention on Combating Bribery of Foreign Public Officials in International Business Transactions) that criminalizes the bribery of foreign officials. Bribes as defined in Article 1 of the OECD Convention can be either payments or any use of the public official's position similar in nature to influence-peddling. Article 1 mainly focuses on the prosecution of the entity paying the bribes; the prosecution of the corrupt foreign public official is not the focus of Article 1 and is left to the legislations and laws of the foreign country. The OECD Convention had an effect on the 1998 amendments of the FCPA. Indeed these amendments expanded the scope of the FCPA to cover "any person" who engages in bribery on U.S. soil. Before the amendments only American individuals or companies that offered bribes could be prosecuted.

Like the OECD and the OAS, the Council of Europe, which is composed of 45 countries and based in Strasbourg, France, adopted the Criminal Law Convention on Corruption in 1999 and asked all member nations to fight and eliminate all forms of corruption. Corruption was defined to include both bribery and "trading in influence" similar to influence-buying. The Council Convention prosecutes both the "person" giving the bribe and the receiver of the latter. It was signed by 36 member nations and 3 non-members, which include the United States. The Council and OECD Conventions, along with the IACAC, are major examples of efforts to address transnational corruption.

## U.S. REGULATION

At the domestic level, developed countries such as the United States have adopted a multi-dimensional approach in their fight against bribery. In the United States, two laws that address public corruption are Section 201 of Title 18 and the Mail Fraud statute. Section 201, enacted in 1962, addresses both the offeror of the bribe and the receiver of "anything of value." The term "anything of value" includes actual financial payments and the promise of future benefit such as employment. In its initial draft, Section 201 was mainly dealing with federal employees bribery prohibition. By 1984, Congress extended the prohibition to state and local officials who receive \$10,000 or more in federal money in a 12-month period; public officials who have been

nominated or appointed to a public office but have not yet assumed office are also subject to the prohibition. Unlike the international conventions, Section 201 also addresses the issue of gratuity provision. Since one cannot bribe an official for a decision that is already made, bribery is forward looking while gratuities can be either forward or backward looking. Section 201 makes after-the-fact gratuities an illegal act, as the official clearly benefits from the exercise of his functions and the offeror of the gratuity increases the likelihood of his future demands to be met by the public official.

The Mail Fraud statute was first adopted in 1872 to protect the post office from being abused as part of a fraudulent scheme, and later adapted to prevent individuals from using the post office to perpetrate frauds on unsuspecting victims. However, in the early 1970s the Mail Fraud statute was largely used by federal prosecutors to attack political corruption (fraud) at the federal, state, and local levels. A public official is said to have committed an act of fraud when he puts his personal, private interests above the public interest; that is a fraud by an official is a violation of his fiduciary duties. Hence, even in the absence of a two-party transaction, the Mail Fraud statute is an effective means as an anti-corruption law.

Experts agree public corruption is not easy to eliminate in any country, whether it is developed or developing. Developed countries should encourage developing countries to adopt or sign-up to conventions such as the OECD or the Council of Europe Conventions and to develop their own regional conventions. Since public corruption flourishes in the dark, transparency should be developed: developing countries should promote greater openness and independence of the media, expand the audit system to all levels of the government, punish corrupt officials but reward honest ones. The international community should be actively involved in the fight against corruption in developing countries by making the allocations of funds conditional on the implementation of concrete anti-corruption measures, or channeling funds through non-government sources. Finally the fight against public corruption should be done at all levels, including the institutional, political, and legal levels.

## SEE ALSO

bribery; Foreign Corrupt Practices Act; mail fraud; corruption; Central America; government contract fraud.

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## puffery

A FORM OF deceptive advertising, puffery has immense consequences. The term refers to the practice of making exaggerated claims for a product. Although advertisers routinely make such false claims, and the result is deception, the law considers such practices to be legal. Puffery claims are communicated in the form of unprovable superlatives (that is adjectives such as the best, super, new and improved), often in the form of various advertising slogans:

Blatz is Milwaukee's finest beer  
Nestle makes the very best chocolate  
Ford gives you better ideas  
You can be sure if it's Westinghouse  
Barnum and Bailey, the greatest show on earth  
Coke is the real thing  
Seagram's, America's number one gin  
Winston tastes good like a cigarette should  
BMW: the ultimate driving machine  
Apple Computers: the power to be your best

None of the slogans are based on objective, factual evidence, and, as such, these claims are either false or unsubstantiated. Even though they are considered legal, their intent is to deceive. The goal, as is always in advertising, is to use whatever tactic will sell a product or service. If that includes distorting the truth, so be it.

Even though knowledge concerning puffery in advertising is far from complete, some important facts have emerged from research on this topic. People perceive more content in ads than the ads actually contain. Additional values are perceived by consumers and attached to products. For example,

one study of sweaters concluded that, when sweaters were shown with belts and captions were read by someone with a Scottish accent, consumers were twice as likely to perceive that the sweaters were imported. Implied deceptions (puffery claims) are believed more than outright lies. In one study of 17 puff claims, 70 percent of respondents felt the claims were either wholly or partially true.

Puffery claims are often indistinguishable from factual claims. In another study, a sample of 100 people were placed in a room and presented with both real and puff claims. The researchers found that "many of the puff claims were believed by a large proportion of the respondents. The subjects could not tell that these puffs might not be literally true." Researchers found that the factual claims were believed just as often as the puff claims used in their survey.

Consumers fed a constant diet of puffery ads may confuse fact and fiction. Moreover, they may actually come to distrust advertising, on the one hand, yet unconsciously be manipulated by it on the other. Puffery claims are most often found in lifestyle advertising. These ads usually contain photos of young, attractive men and women depicted in opulent surroundings (for example, beautiful white beaches, penthouse apartments, or luxurious mansions). The photos contain implied promises concerning popularity, sex appeal, power, success, and love—if one uses the product being advertised. The puff claims along with the implied promises in the ads constitute a major form of social structural alienation known as inauthenticity.

Inauthenticity consists of positive overt appearances (that is, the puffery slogans and implied promises) coupled with negative underlying realities that come from a mass consumption lifestyle. This lifestyle includes, for example, consuming dangerous products, generating pollution, depleting resources, chronic indebtedness, envy crimes, and even bankruptcy from spending too much money on mass consumption.

SEE ALSO  
advertising fraud; False Claims Act.

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## Pure Food, Drug and Cosmetics Act

THE PURE FOOD movement, which surfaced in the decade after the Civil War and the appointment of Dr. Harvey W. Wiley as the sixth head of the Department of Chemistry, was the motivating force behind the early call to prevent the sale of harmful, tainted, or misbranded food and drugs being sold in the United States. In response to these efforts, Congress passed the Food and Drug Act of 1906 over the objections of the whiskey distilleries and the patent food industry which were afraid the new law would put them out of business. With the passage of the law, federal officials had the authority to seize illegal products and to prosecute those who manufactured them. By 1908, Wiley employed 28 food and drug inspectors. A separate law was also passed to regulate the quality of meat in response to Upton Sinclair's exposé of the meat packing industry in *The Jungle*. The Insecticide Act of 1910 placed restrictions on the use of pesticides, banning the manufacture, sale, and transport of harmful and ineffective pesticides. In 1913, Congress mandated uniform weights and measures on food and drug labels.

Drawing on his extensive research, Wiley faced down legal challenges to the 1906 law, convincing the courts to uphold the right of the federal government to protect American consumers. Wiley also drew up the first *Inspector's Manual*, which provided federal inspectors with scientific methods to test the safety of products. In 1926, the authority to regulate food and drugs was transferred to the newly created Food, Drug, and Insecticide Administration, which became the Food and Drug Administration (FDA) in 1931. The election of Franklin D. Roosevelt in 1932 helped to provide the FDA with the support it needed to protect Americans from harmful and unwholesome foods, and from drugs

that could be fatal or which failed to live up to their claims.

Under Wiley's leadership, the FDA gathered together what became known as the "American Chamber of Horrors" to convince legislators and the public of the need for reform in the food and drug industries that went beyond the 1906 act. His display included: Banbar, a product that falsely promised to cure diabetes; Lash-Lure, a mascara that blinded a number of women; Radithor, a lethal tonic that contained radium; Wilhide Exhaler, which was inaccurately advertised as a cure for tuberculosis and a host of other illnesses; and a variety of foods that had been falsely labeled and/or packaged. Before his death in 1930, Wiley synthesized his research and his goals into a six-page proposal for what became the 1938 Federal Food, Drug and Cosmetic Act. The new law banned the manufacturing and interstate shipment of tainted and falsely labeled food and drugs.

During the five-year battle to pass the Food, Drug, and Cosmetic Act, Arthur Kallet and F. J. Schlink, published *One Hundred Million Guinea Pigs: Dangers in Everyday Foods, Drugs, and Cosmetics*, creating further public outcry about the dangers of a number of products that Americans consumed on a daily basis. This work, coupled with the efforts of Wiley and the FDA were still not enough to push Congress toward consumer reform until a major medical catastrophe occurred. In 1937, a Tennessee company, Massengil, sold a tonic that it claimed was safe enough for pediatric use. In reality, the tonic contained ethylene glycol, an element used in engine antifreeze, and its use resulted in the deaths of at least 100 Americans, many of them children. No safety testing had been performed on the product before it had been unleashed on unsuspecting consumers.

The Federal Food, Drug and Cosmetics Act of 1938 required that drug manufacturers provide scientific proof of drug safety and regulated cosmetics and medical devices for the first time. After the law went into effect, the federal government no longer had to prove fraud to stop manufacturers of drugs from making false claims about their products. The law also banned the addition of any kind of poisonous substances to food, except in the rare case when it was either necessary or unavoidable. For example, residues of pesticides used on fruits and vegetables might be considered unavoidable. For the first time, the FDA was given the authority to obtain injunc-

tions to prevent the manufacture and marketing of illegal products.

In the decades following the passage of the Pure Food, Drug and Cosmetics Act, the widespread use of amphetamines and barbiturates claimed a lion's share of the FDA's attention. A number of amendments to the 1938 law were passed as a result of the agency's continued efforts to protect consumers. In 1954, Congress passed the first laws regulating the use of pesticides on food products. Food additives were regulated in 1958, followed by regulation of color additives two years later. In 1962, in response to the threat of thalidomide, a European tranquilizer that produced horrific birth defects in babies born to women who had taken the drug, the Kefauver-Harris Amendment required the FDA to re-evaluate all drugs that had been introduced in the United States since 1938.

The FDA was also given greater authority over drug trials and improved access to manufacturer's records for purposes of verification. The amendment transferred control of drug advertising from the Federal Trade Commission to the FDA. In 1968, Congress created the Drug Enforcement Administration and brought veterinary medicine under FDA authority. In 1976, the scandal that erupted over the use of the Dalkon Shield, an intrauterine device that caused deaths, birth defects, infertility, and a number of other problems for its users, led to the Medical Device Amendment that gave the FDA the right to regulate medical devices.

In contemporary terms, the 1938 Pure Food, Drug, and Cosmetics Act and its amendments have given the FDA the authority to regulate the contents, manufacture, distribution, and advertising of food, drugs, medical devices, and cosmetics and to mandate scientific testing as ways to ensure safety and effectiveness, along with civil and criminal enforcement authority. FDA authority over food includes the authority to regulate food-borne illnesses, and changes in labeling requirements for food have mandated information about vitamins,

minerals, and calories as well as specific weights and measures of products. The FDA has regulatory authority over both biological and therapeutic substances that are classified as drugs, including all prescription and over-the-counter (OTC) drugs. The inclusion of medical devices has provided FDA oversight for devices from contact lenses and hearing aids to pacemakers and breast implants.

Mandates for cosmetic labeling have included content labeling, adverse reactions that have been noted in testing, and the presence of alphahydroxy acids in the product. Penalties for violation of the laws include fines from \$50,000 to \$1,000,000, depending on the number of charges.

The FDA also has the authority to confiscate illegal products, to obtain injunctions to prevent the manufacture and distribution of illegal products, to force the recall of faulty products, and to debar drug manufacturers who have committed serious violations of drug regulations. While the FDA has the task of ensuring the safety of foods, drugs, medical devices, and cosmetics, consumers share a responsibility for educating themselves about potential hazards.

#### SEE ALSO

pesticides; Dalkon Shield; A. H. Robins; pharmaceutical industry; Environmental Protection Agency; Food and Drug Administration.

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# R

## racial discrimination

PREJUDICE IS the attitudinal element in enforcing racial and ethnic stratification, while discrimination is the active, or behavioral, element. Discrimination involves behavior aimed at denying members of particular ethnic groups equal access to societal rewards. It may be of an individual or institutional nature and *de jure* (in law) or *de facto* (in fact).

Actions taken by individuals or groups of limited size to injure or deny members of minority ethnic groups are perhaps the most easily understood form of discrimination. The employment manager who refuses to hire Asians, the judge who metes out unusually harsh sentences to African Americans, and the homeowners' group that agrees not to sell in the neighborhood to Jews are examples of discriminators at this level.

In these cases, actions are taken by one or few with the intent to harm or restrict in some way members of minority groups. In cases of individual discrimination, the actions taken against minority groups' members are intentional. At first glance, we might assume that the employment manager thinks unfavorably of Asians, the judge dislikes African-Americans, and the homeowners hate Jews. This may, in fact, be the motivating force behind the discrimination in all these cases, but we cannot be certain until we understand more fully the context in

which these actions occur. The employment manager, for example, may have no ill feeling toward Asians but may feel compelled to carry out what he perceives to be the unwritten, yet generally understood company policy of not hiring Asians. The judge may feel that sentencing African-Americans more harshly will gain her votes among her predominantly white constituency in the next election. And the members of the homeowners' group may simply be responding to what they feel are neighborhood pressures.

Discrimination, however, may be legal or customary, in which case it is not socially unexpected or disapproved of, but is legitimized. This is called *de jure* (in law) discrimination. In the United States before the 1960s, there were centuries of a well-institutionalized system of racial discrimination in the law. This blocked the access of African-Americans and other racial minorities to economic, political, and social opportunities afforded to whites.

## AFRICAN AMERICANS

In *de jure* racial discrimination, racism has been an integral part of American law since the first slaves arrived in Virginia in 1619. A century and a half later, a new nation, composed in large part of slaveholders, made a Declaration of Independence in which they bore witness to the world that "all men

are created equal.” Twenty years after Columbus reached the New World, African natives, transported by Spanish, Dutch, and Portuguese traders, were arriving in the Caribbean Islands. Almost all came as slaves. By 1600, there were more than half million slaves in the Western Hemisphere.

In Colonial America, the first African Americans landed at Jamestown, Virginia with the earliest settlers. Within 40 years, they had become a group apart, separated from the rest of the population by custom and law. Treated as servants for life, forbidden to intermarry with whites, deprived of their African traditions, and dispersed among Southern plantations, African Americans lost tribal, regional, and family ties. Colonial legislation generally barred marriage between whites and African Americans. These laws were intended to provide “a perpetual and impassible barrier” between whites and African Americans.

Through massive importation, slave numbers increased rapidly. By 1776, some 500,000 African Americans were held in slavery and indentured servitude in the United States. Nearly one of every six persons in the country was a slave. The earliest slave statutes arose in New York, Connecticut, Massachusetts, and Virginia. Black slaves were treated in law as property, and this became part of the Constitution, given that slavery a well-established institution by that time. Slave laws allowed masters total control over their property, including whipping and killing their slaves. White Northern states abolished slavery in the early 1800s, they still maintained legal restriction on free slaves regarding employment, education, and voting. They were not equal in the eyes of the law. Slavery remained a major economic and social institution in the South and the Dred Scott decision by the Supreme Court of the United States in 1857 affirmed their inferior status.

## CIVIL WAR

The Civil War was begun largely for Constitutional and economic reasons, due to the secession of the South from the Union. President Abraham Lincoln issued a preliminary warning to states that had seceded and joined the Confederacy that he would free their slaves January 1, 1863 if they did not rejoin the Union. The Proclamation Emancipation was declared on January 1, 1863 freeing slaves in the Confederate states. The campaigning to enact the

Thirteenth Amendment abolishing slavery began in 1864 while large numbers of African Americans soldiers were in combat. By the time the Thirteenth Amendment was signed by Lincoln on February 1, 1865, there were 200,000 African Americans in the Union army.

While African-Americans made progress immediately after the Civil War, they were again subjugated by law and violence. Within a decade it became apparent that the Thirteenth Amendment abolishing slavery was obsolete. Southern planter could achieve the same benefits with less burden through the sharecropping system and stark violence. The Fifteenth Amendment, politically obsolete at its birth, was not effectively enforced for almost a century. The Fourteenth Amendment, impassable as specific protection for African-American rights, was enacted finally as a general guarantee of life, liberty, and property of all “persons.”

Corporations, following a period of ambivalence, were deemed persons under the Fourteenth Amendment, and for several generations received far more protection from the courts than did African-Americans. Indeed, African-Americans became victims of judicial interpretation of the Fourteenth Amendment and legislation based on it so narrow as to render the promised protection meaningless in virtually all situations. Violence against freed slaves abounded, and the Ku Klux Klan arose in the 1870s as an expression of prevailing attitudes.

The Civil War Amendments and the Civil Rights Acts in the 1860s and 1890s were to remain empty as federal government tools; the courts and state laws allowed a “separate but equal” policy to arise in the United States. Segregation laws were legitimated in 1896 in the case of *Plessey v. Ferguson* by the U.S. Supreme Court allowing the country to maintain an apartheid, segregationist system until the civil rights movement and legal changes beginning in the 1950s and 1960s.

## NATIVE AMERICANS

Building on models already tested by the Spanish, the French, and the British, America advanced its takeover of the American landscape through treaties (easily made and as easily abandoned), open warfare waged with, first, superior weapons and, later, with overwhelming numbers, and, ultimately, through genocide. The absence from the Constitution of the general power over Native American af-

fairs is not surprising to students of history, for at the time the Constitution was drafted, the framers regarded Native American tribes as sovereign nations, albeit nations that would soon either move west, assimilate, or become extinct. The judiciary further solidified the analogy of Native American affairs to foreign affairs. Although courts analogized tribe nations to foreign nations in finding Congressional power to deal with them, it is important to note that the courts did not view tribes as possessing all the attributes of a sovereign foreign nation.

In the first Cherokee case, *Cherokee Nation v. Georgia*, the Supreme Court held that Native American nations were not foreign states for the purpose of invoking the court's original jurisdiction. The nation was neither a state of the Union nor a foreign state, but a "domestic dependent nation" incapable of conditioned foreign relations with countries other than the United States. Instead, "their relation to the United States resembles that of a ward to his guardian."

In *Cherokee Nation v. Georgia* (1831) Chief Justice John Marshall suggested Native American tribes were "domestic dependent nations" whose relationship was later to be implemented through the paternalistic colonialism manifest in the reservation system. Furthermore, laws and treaties made by the United States government with the Native American tribes were infamous for their "flexibility." Under the legal Doctrine of Discovery, the U.S. Supreme Court in *United States v. Kagana* (1886), gave Congress the power to govern reservations. Although nominally protected by the individual rights provisions of the Constitution, like other non-citizens, Native Americans and their tribes, in fact, could not vindicate their rights in the courts. The General Allotment Act of 1887 provided that Native Americans receiving allotments under any treaty or statute would become citizens. The act also declared Native Americans living separate and apart and "adopting the habits of civilized life" to be citizens. It was not until 1960 that all Native Americans received citizenship.

## CHINESE

The Chinese were the first Asians to immigrate to California. Primarily laborers from Kwantung Province, they emigrated from China to escape the great hardships that followed the Taiping Rebellion of 1850 to 1864. The discovery of gold at Sutter's

Mill in 1848 greatly increased the attractiveness of California for the Chinese. Much of the immigration was the product of the "coolie trade," an arrangement by which Chinese laborers were imported under contract that amounted to a form of slavery.

By 1860, they outnumbered the other immigrant groups in California and had earned the animosity of white labor groups by being "too efficient." The California legislature passed laws and regulations designed specifically to create social and economic hardships for the Chinese. The statutes ranged from a "foreign miner's tax" to a "police tax" and a "cubic air" ordinance.

Two important court decisions, however, were sources of particular trouble to the Chinese. In 1854, the California Supreme Court ruled that the laws of the state exclude all people of color from giving evidence in court either for or against a white person, and, in 1867, a federal court held that the Chinese aliens were not eligible for naturalization.

The Chinese Exclusion Act of 1882 became the first exclusively racial immigration law. The Geary Act of 1892 extended the suspension for an additional 10 years, and, in 1902, the suspension was converted into permanent exclusion. The Act of 1892 provided that all Chinese laborers lawfully in the United States were required to obtain certificates of residence or face deportation. The Chinese raised large sums of money to sponsor litigation challenging the constitutionality of the act, but the Supreme Court upheld the Geary Act. The court held that the determination of Congress was conclusive on the judiciary, and that the government has the inalienable right to expel all of any class of aliens, "absolutely or upon certain conditions, in war or in peace."

In 1927, the court found that no equal protection violation resulted from the exclusion of a child with some Chinese blood from white schools under state law. Due in part to China being an American ally in World War II, an act of 1943 repealed all previous exclusion acts and established a token quota of 100 Chinese immigrants. This act was also to counter Japanese propaganda against the United States. The Chinese gained the right of naturalization and were taken out of the category of citizens "ineligible for naturalization," a phrase used in discriminatory law against Asians.

The law remained prejudicial, however, in that only Asians did not fall under the national origins



system. A Chinese immigrant was put under the Chinese quota even though his national origin was English or Malayan. It was not until 1965 that an amendment to the 1952 Act eliminated discrimination against Asians in the immigration laws.

## JAPANESE

The Japanese, who in 1890 began immigration to the United States in large numbers, arrived on the West Coast at one of the most inopportune periods in American history. Anti-Chinese feeling had reached its peak, and this hostility was easily transferred to the new Asians arrivals.

In 1906, the San Francisco Board of Education then controlled by the Labor Party, decided to enforce an ordinance passed the previous year that would segregate the city's Asian children. Racism and exclusion did not take the form of only exclusion acts in 1913; California enacted the Alien Land Laws. Many states followed suit. The laws were designed to prevent Japanese immigrants from earning a living in agriculture, thereby driving them out of the state.

But in the 1920s, the Alien Land Laws did not seem sufficiently restrictive to many Americans, and in 1924 an exclusion act was passed. The Quota Act of 1924 excluded from immigration "aliens ineligible to citizenship." Japanese aliens were not to gain the right to citizenship until the Walter-McCarren Act of 1952.

On February 19, 1942, President Franklin D. Roosevelt issued Executive Order 9066, "giving authority to certain military commanders to prescribe military areas from which any or all persons may be excluded, and with respect to which the right to enter, remain in, or leave, shall be subject to the discretion of the military commander." The War Relocation Authority relocated Americans of Japanese ancestry into internment camps. On March 18, 1942, this segregation was upheld by the U.S. Supreme Court in *Korematsu v. United States*.

In addition to loss of freedom, property, education opportunities, businesses, and employment income, the 120,000 people of Japanese ancestry interned (more than two-thirds native-born Americans citizens) were subjected to onerous living conditions. After great pressure decades later, President Ronald Reagan signed the Civil Liberties Act of 1988, setting in motion the statutory means by which Japanese Americans who were interned

would receive federal reparations payments. Government implementation of the measure has been slow, and it is estimated that only about 60,000 survivors or their next of kin will be paid. About half of the internment survivors died before the legislation was passed.

*De facto* racial discrimination is the situation in the United States since the civil rights movement of the 1950s and 1960s and the elimination of most of the exclusionary and segregation laws. These discriminations may not be lawful as in employment or housing discrimination, yet segregated housing patterns, racial profiling, high rates of incarceration and unemployment of African-Americans and Hispanics reflect *de facto* discrimination. This remains the major challenge in race and ethnic relations.

## SEE ALSO

gender discrimination; age discrimination; United States; American Civil War.

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## racketeering

RACKETEERING CAN BE generally defined with reference to an individual (a racketeer) who uses extortion, loan sharking, bribery, or obstruction of justice to further her illegal activities. Often, an individual who practices racketeering may also use her formal authority or some type of formal or informal power to illegally persuade others to further her interests. Although definitions of the term racketeering are contained within U.S. Federal statutes, these definitions have been criticized by legal scholars, who have argued that the definitions are too

vague and ambiguous. The official definition of racketeering can be found in the Organized Crime Control Act of 1970, or Public Law 91-452. Interestingly, a synonym for racketeer is fraudster, a label that is often used to describe white-collar and corporate offenders.

In the field of criminology, racketeering almost immediately brings to mind images of organized crime, as opposed to white-collar or corporate crime. The same image tends to hold for the related and often interchangeable term, racketeering activity. However, researchers focused on this area of study have readily acknowledged that the line between white-collar crime, corporate crime, and organized crime is often blurred. To successfully operate a criminal organization, also known as a mafia, at least some amount of support from the larger society is needed. Organized crime members may further their criminal interests by involving legitimate businesses and their representatives in their activities.

For example, corrupting legal officials such as police, judges, and legislative officials may occur through bribery or blackmail. Available research on this topic demonstrates that certain industries have historically been more likely to become involved in the activities of organized criminal groups. These industries have included gambling, trash collecting, and freight loading. Many of the racketeering activities associated with these industries have been referred to as white-collar crime, rather than organized crime.

## A CHALLENGING ENDEAVOR

The overlap between white-collar crime, corporate crime, and organized crime can also be seen more clearly by examining the legal responses to a variety of criminal and civil violations. Many of these acts occur within the context of legitimate business operations, making their detection and eventual punishment a very challenging endeavor. Studies of corporate crime have documented the numerous difficulties that may be associated with the prosecution of organizations.

For example, determining punishment for an organization can be problematic when offenses include several individuals acting on behalf of the legitimate business. Unlike the case of a single offender, some of the more severe sanctions, such as incarceration, cannot be levied against an entire

organization. Historically, one of the most common available sanctions for organizational defendants has been in the form of a monetary fine.

Over the last two decades, additional punishment options for organizational defendants, as well as criminal individuals, have become available through the Racketeer Influenced Corrupt Organizations (RICO) Act. A provision of the aforementioned Organized Crime Control Act, the RICO statute was originally enacted by Congress to target the criminal enterprises of organized crime families. In fact, it is viewed legally as the primary means of convicting known mobsters or gangsters.

In addition to enabling prosecutors to file charges against criminal groups, RICO has allowed the seizure of assets that are the product of criminal activities and has permitted harsher punishment of offenders. A variety of offenses fall within the boundaries of RICO, and a "pattern of racketeering activity" includes involvement in two acts within a 10-year span. The acts that may be included within this time frame vary considerably. To be charged with racketeering under the RICO Act, a person must be employed or associated with a criminal enterprise. The statute of limitations for prosecuting a RICO violation is five years for criminal prosecution and four years for civil prosecution.

Although RICO covers violent crimes such as murder and kidnapping, several of the offenses encompassed within the statute may be viewed as synonymous with white-collar and corporate crime. These include counterfeiting, financial institution fraud, money laundering, mail fraud, securities fraud, wire fraud, embezzlement from welfare funds, theft by deception, and extortionate credit fraud. RICO has also been used in the successful prosecution of individual and corporate offenders charged with various forms of consumer fraud, such as false advertising.

In a variety of business disputes and commercial litigation consistent with white-collar and corporate crime, such as fraud, civil RICO is more likely to be used against a defendant than criminal RICO. Such claims are often attached to a suit by the plaintiffs as a means of increasing the defendant's exposure to the public. One of the most well-known individuals prosecuted under the RICO Act was junk bond magnate Michael Milken, whose crimes included bond market manipulation, securities fraud, and tax fraud. In 1990, Milken was sentenced to 10 years in prison for these offenses.

## SEE ALSO

Racketeering Influenced Corrupt Organizations; prosecution; organized crime; Milken, Michael.

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## Racketeer Influenced Corrupt Organizations

IN THE UNITED STATES, the Racketeer Influenced Corrupt Organizations (RICO) statute is considered the most significant piece of legislation targeting organized and white-collar crime ever enacted. While derided in many circles as an unfair infringement on such ingrained constitutional rights as due process, it has been used extensively and successfully to prosecute thousands of individuals and organizations in the United States.

Part of the Organized Crime Control Act of 1970, RICO makes it unlawful to acquire, operate or receive income from an enterprise through a pattern of racketeering activity. Geared toward ongoing, organized criminal activities, the underlying tenet of RICO is to prove and prohibit a pattern of crimes conducted through an "enterprise," which the statute defines as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact, although not a legal entity."

Under RICO, it is a crime for an individual to belong to an "enterprise" that is involved in a pattern of racketeering, even if the racketeering was committed by other members. Specifically, Section 1962 of RICO prohibits "any person" from: a) using income received from a pattern of racketeering activity or from the collection of an unlawful debt to acquire an interest in an enterprise affecting interstate commerce; b) acquiring or maintaining through a pattern of racketeering activity or

through collection of an unlawful debt an interest in an enterprise affecting interstate commerce; c) conducting or participating in the conduct of the affairs of an enterprise affecting interstate commerce through a pattern of racketeering activity or through collection of an unlawful debt; or d) conspiring to participate in any of these activities.

In order for an individual or organization to be convicted of racketeering under RICO, there must be proof of a "pattern" of illegal offenses, which RICO defines as the commission of at least two identified criminal offenses within a 10-year period. RICO defines racketeering in an extremely broad manner and includes many offenses that do not ordinarily violate federal statutes: "any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under state law and punishable by imprisonment for more than one year."

In addition, RICO lists numerous federal offenses that the statute defines as racketeering: bribery, sports bribery, counterfeiting, embezzlement from union funds, loan sharking, mail fraud, wire fraud, obstruction of justice, contraband cigarettes, prostitution and trafficking in people, bankruptcy fraud, drug violations, and obscenity. As long as the "racketeering activity" is "chargeable" or "indictable" under an applicable criminal statute, the substantive RICO charge is available.

RICO creates offenses and penalties, above and beyond those proscribed for specific criminal offenses, for those involved in an ongoing illegal enterprise that engages in racketeering. The maximum criminal penalties for violating RICO include a \$25,000 fine and imprisonment for 20 years.

These penalties are imposed on top of the criminal penalties resulting from two or more substantive offenses that the individual or organization has committed in the 10-year period. In addition to the criminal penalties, there are forfeiture provisions requiring the violators to forfeit any business or property derived from their illegal offenses.

In addition to criminal actions, RICO permits private plaintiffs and the government to seek redress in a civil action. Indeed, perhaps the most controversial aspect of RICO is that the government can seize and confiscate what it deems to be the proceeds of crime through the civil courts. RICO allows the government or a private citizen to file a civil suit requesting the court to forfeit assets,

order sanctions, or to provide injunctive relief against an individual or organization involved in a “pattern of racketeering.” The civil action provisions of RICO can: force a defendant to forfeit any interest in property, restrict a defendant from engaging in certain future activities or investments, or dissolve or reorganize an enterprise. These penalties were intended to address the economic roots and organizational infrastructure of ongoing criminal conspiracies.

With respect to asset forfeiture, the state can seize property without notice, upon an *ex parte* application of probable cause that the property is associated with criminal activity. In this case, criminal charges need not be provided against a defendant. In contrast to criminal prosecutions, where the burden of proof is beyond a reasonable doubt, only the lesser standard of proof—a balance of probabilities—is required under the civil provisions of RICO. The attraction of this approach is that the onus of proof is shifted to the defendant who must prove that assets were acquired through legitimate means. Civil RICO injunctions can prohibit individuals from owning or becoming involved in certain legitimate or illegitimate businesses or activities. Moreover, if successful, the victim may be able to recoup treble damages (that is, the defendant must pay to the plaintiff three times the amount of damages, as well as legal expenses, that have been determined by a court).

While it took some time for federal prosecutors to fully understand and incorporate RICO into their array of prosecutorial tools, the statute has been increasingly used and has realized much success. By 1990, more than 1,000 major and minor organized crime figures had been convicted and given lengthy prison sentences under RICO. “The hierarchies of the five New York LCN [La Cosa Nostra] Families have been prosecuted, and similar prosecutions have dented the LCN hierarchies in Boston, Cleveland, Denver, Kansas City, Milwaukee, New Jersey, Philadelphia, Pittsburgh and St. Louis,” the Pennsylvania Crime Commission reported in 1991. Rudolph Giuliani, the former U.S. attorney for the Southern District of New York, who successfully used RICO in prosecuting organized crime cases, points out:

The federal prosecutor derives a variety of benefits from the RICO statute’s definitions of enterprise and racketeering activity. For example, it

is the only criminal statute that enables the government to present a jury with the whole picture of how an enterprise, such as an organized crime family, operates. Rather than pursuing the leader of a small group or subordinates for a single crime or scheme, the government is able to indict the entire hierarchy of an organized crime family for the diverse criminal activities in which that “enterprise” engages. Instead of merely proving one criminal act in a defendant’s life, it permits proof of a defendant’s whole life in crime.

Giuliani provides an example of the successful RICO prosecution of one of New York’s five LCN crime families, arguing it constituted a criminal enterprise that engaged in an ongoing pattern of racketeering. Fourteen defendants were indicted under RICO as leaders, members, or associates of the Colombo crime family. In establishing that an “enterprise” existed, the indictment identified three bosses and five under-bosses of the family, all of whom were all charged with supervising and protecting the criminal activities of the subordinates of the criminal enterprise. The ongoing nature of the enterprise was demonstrated by the fact that the Colombo family selected an acting boss to direct its criminal activities while the head of the family was in jail. According to Giuliani, relying entirely upon traditional conspiracy laws without RICO would not have enabled the government to include all of these individuals within a single prosecution.

In addition, RICO’s requirement of proving a “pattern of racketeering activity” and its broad definition of “racketeering activity” allowed the prosecution to join in a single indictment the widely diverse state and federal crimes the Colombo family had engaged in over the past 15 years. Thus, the indictment included charges that the criminal organization had engaged in extortion, labor racketeering, drug trafficking, gambling, loan sharking, and both state and federal bribery violations.

## THE COMMISSION CASE

The use of the RICO statute by the U.S. government resulted in one of the most important prosecutions ever brought against organized crime in the United States. On November 19, 1986, in what became known as the Commission Case, several New York Mafia bosses were convicted of conducting

the affairs of “the Commission of La Cosa Nostra” in a pattern of racketeering that violated the RICO statutes.

The theory behind the government’s case was that the LCN Commission constituted a criminal enterprise and that each defendant had committed two or more racketeering acts in furtherance of the commission’s goals. According to the prosecution, the defendants’ predicate racketeering acts fell into three categories: 1) management of a multi-family bid-rigging and extortion scheme in the New York concrete industry; 2) conspiracy to organize loan sharking territories on Staten Island; and 3) the murders of Bonanno family boss Carmine Galante and two of his associates in furtherance of the commission’s effort to resolve a Bonanno family leadership dispute.

During the course of the trial that resulted from the RICO indictments, defense counsel admitted the existence of the LCN and the Commission. They denied, however, the Commission’s involvement in criminal activity, but to no avail: in 1986 all of the defendants, including Carmine Persico, boss of the Colombo Family, Anthony Salerno, boss of the Genovese Family, and Anthony Corallo, boss of the Lucchese Family were found guilty.

While the original purpose of RICO was to address organized crime, the broad wording of the RICO statute, and its failure to define “racketeering,” has meant that both the criminal and civil provisions of RICO have been applied to a number of offenses and defendants, and not just those typically associated with organized crime. Other RICO defendants include terrorists, anti-obscenity protesters, adult video and bookstore owners, financial institutions, politicians, doctors, law enforcement personnel, husbands who have been sued by their ex-wives for defrauding them of marital property, construction workers who sexually harassed a female co-worker, and the drivers of a bus company who inflicted property damage during a strike.

## THE REACH OF RICO

Court cases have also expanded the reach of RICO. In *Sedima, S.P.R.L. v. Imrex Co.*, the U.S. Supreme Court concluded that RICO is not limited to organized crime, but may be applied to legitimate commercial enterprise businesses. The Belgian company Sedima filed an action against rival Imrex in the U.S. District Court in 1982, alleging that Imrex inflated

its purchase prices and costs by preparing fraudulent purchase orders and credit memos. The action was originally dismissed by a lower court on the grounds that no RICO injury occurred, and the court’s decision was upheld on appeal.

## A PLETHORA OF SUITS

However, the Supreme Court reversed the appellate decision, considerably broadening RICO’s scope, and initiating a plethora of civil and criminal suits involving legitimate companies. Following this decision, RICO was increasingly used by the government to prosecute white-collar and corporate crime offenses, as well as unfair trade practices, committed by legitimate companies not associated with organized crime groups.

For example, in 1988 federal prosecutors brought a RICO indictment against a securities firm called Princeton/Newport Partners. Although prosecutors sought less than \$500,000 in illegal profits, they required the firm to post a bond of \$24 million, which forced the company to declare bankruptcy. Many of the civil suits launched by RICO have not been undertaken by the government, but by private citizens and private sector companies. Arguably, RICO-based legal actions directed toward white-collar and corporate crime are most frequently undertaken by private citizens and companies as civil suits, no doubt attracted by the prospect of treble damages. In a *New York Times* opinion piece, privacy and consumer rights advocates argued that RICO:

... is among the few effective tools against economic crime. Law enforcers have used its enhanced criminal penalties against insider trading and government corruption. ... Civil RICO has been a powerful tool against white-collar crime. For example, federal bank regulators have brought suits against those who purportedly looted savings and loans. ... Civil RICO’s multiple damages let moderate-income consumers have their day in court too. Victims of retirement home fraud, home improvement fraud, and investment scams have successfully used the law to recover their losses when no other effective remedy was available to them.

Critics of the civil application of RICO to legitimate commercial enterprises argue that RICO is a statute run amok and no one is be-

yond its reach. Many times a day, unsuspecting citizens and businesses are shocked to find that they are targets of RICO suits. The law's broad civil suit provisions cast a net so wide that virtually any commercial dispute becomes a candidate for civil RICO jurisdiction. ... Most cases involve the kind of commercial disputes that are part and parcel of the complex web of relationships that define the American economy.

In the last few years, hundreds and perhaps thousands of RICO civil suits have been launched alleging white-collar and corporate crime. Some actions initiated in recent years and summarized in the June 2003 edition of the *RICO Law Reporter* include the following:

Health management organizations launched a RICO civil suit against drug manufacturers, claiming that the defendants released inflated average wholesale prices for their drugs on which Medicare-based payments were unable to allege a proper RICO enterprise.

A plaintiff, who claimed he had been fraudulently deprived of control over a corporation by his nephew launched a civil suit under the mail fraud provisions of RICO.

Plaintiffs claiming that they had been defrauded by their company president's moonlighting for another firm sued the president under RICO. An importer sued a bank under RICO asserting that the bank's adverse credit actions had caused it to default on a supply contract.

All of these suits were unsuccessful, primarily because the plaintiffs could not establish that the defendants were engaged in a pattern of racketeering. Despite the frequent civil actions undertaken through RICO, significant limitations remain on the availability of private civil RICO claims. Civil RICO is not available to compensate the economic consequences of personal injuries sustained as a result of a RICO predicate criminal act. Additionally, the Supreme Court has decided that plaintiffs are required to prove that the alleged RICO violation was the proximate cause of their injury. In 1992, the Seventh Circuit Court ruled that civil RICO was also limited by a requirement that either the enterprise or the racketeering activity be economically motivated. However, the Supreme Court eliminated this requirement, allowing for the possibility that purely political, non-economic criminal activity may now fall within the ambit of RICO.

As a result of this decision, civil RICO actions have been undertaken to address non-economic "criminal" activity. For example, RICO have been used successfully by abortion clinics to sue anti-abortion protest groups for damages. A jury in the case awarded the plaintiff abortion clinics \$86,000 in April 1998, based on RICO claims of extortion, conspiracy, and threats of violence. The court also retained jurisdiction for 12 years to enforce a permanent injunction barring the defendants from further blockades of abortion clinics.

RICO has also been used in the context of labor prosecutions. In June 1988, the U.S. district attorney for the Southern District of New York filed a motion under RICO seeking to have the entire executive board of the International Brotherhood of Teamsters (IBT) removed from office and replaced by a federally appointed trustee. The premise underlying this action was that the IBT was so extensively influenced and controlled by organized crime as to constitute a corrupt organization, and its officers were so involved in racketeering that they must be removed from office.

## CRITICISMS

RICO has been at the center of vociferous criticisms. Author Howard Abadinsky cites four basic criticisms of RICO that have been raised: First, RICO is overreaching, leading to the prosecution of individuals who, although they may have been involved in criminal behavior, are not by any stretch of the imagination connected to organized crime.

Second, invoking RICO can result in assets being frozen even before a trial begins, an action that can effectively put a company out of business. The threat of freezing assets can induce corporate defendants to plead guilty even when they believe themselves to be innocent.

Third, a RICO action brings with it the stigma of being labeled a racketeer which may be inappropriate given the circumstances at issue.

Fourth, RICO permits lawsuits for triple damages when ordinary business transactions, not organized crime or racketeering, are at issue.

To these four, we can add one more: the application of the civil legal process to criminal offenses, which is an easier way for the government to combat organized crime, yet may contravene the right of the defendant to her right to due process accorded as part of a criminal charge.

## SEE ALSO

organized crime; racketeering; corruption, Giuliani, Rudolph; Green, Mark; bribery; prosecution.

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## Reagan, Ronald (1911–2004)

RONALD REAGAN SERVED as the 40th President of the United States from 1981 to 1989. The former film actor turned to politics after serving in various positions such as the president of the Screen Actors Guild (SAG) and as the spokesman for General Electric. Then in 1967, he was elected governor of California, which would eventually open the doors that led him to the White House.

His politics were conservative, focusing heavily on tax cuts, pro-military government, and anti-communism. "Reaganomics," as his economic policy was usually referred to, was supposedly similar to the traditional principles that helped form the foundation of the American way of life. Unfortunately, Reagan's economic policy suffered from numerous

contradictions, the chief among these being that increased defense spending together with cuts in taxes for corporations and rich individuals would somehow result in a balanced federal budget. The result was a quadrupling of the federal debt in just eight years. Aside from his support of big business interests, Reagan is most widely known for yet another declaration of a war on drugs, the fourth such war in the last century.

Reagan's involvement in political scandal was widespread. In fact, over 120 of his appointees resigned due to being indicted, convicted, or being under an unethical cloud. This is the largest number of corruption cases of any administration in American history.

### IRAN-CONTRA

In 1986, the Reagan administration was faced with the Iran-Contra scandal that dealt with policy decisions based on anti-communism, covert operations and, a subsequent cover up. The controversy arose when members of Reagan's administration agreed to sell arms to the Iranian government for the release of American hostages held in Lebanon and elsewhere. The administration gave the revenue from the sale to the anti-communist rebels, the Contras in Nicaragua. These events were investigated and there was a national hearing in 1987. The Congressional investigating committee stated that Colonel Oliver North, a White House staffer, had violated the law, but later court trails failed to convict him. This act by the Reagan administration violated the Arms Export Control Act, the Boland Amendment, and the National Security Act of 1947.

Previously, Congress had declared that it was unlawful to sell arms for hostages and to support civil wars on foreign soil without Congressional approval. Under the Boland Amendment, Congress also ordered all military aid to the Contras ceased (after it was discovered that the CIA mined the harbor in Nicaragua's capital). The Reagan White House hired an entire group of ex-military members, along with arms dealers and former CIA officials, that became known as the Enterprise to sell arms to Iran and send some of the profits from that sale to the Contras. Reagan's administration also solicited secret contributions from rich Republicans and foreign governments, in violation of the Boland Amendment.

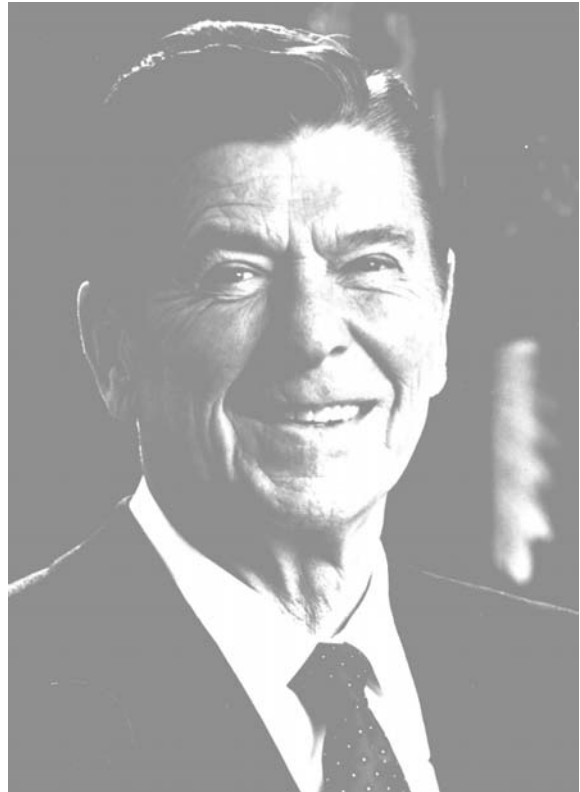
The Tower Commission that investigated the Iran-Contra scandal did not feel that the President was directly responsible for the scandal. The commission did, however, criticize Reagan for his lack of supervision over his subordinates. They argued that it was his supervision deficiency in this area that created the atmosphere for the scandal to occur. Special prosecutor Lawrence Walsh was quoted as saying that Iran-Contra will be remembered in history "as a non-sordid disregard of constitutional restraints. ... I think the president was wrong, he was defiant, he was deliberate, but he wasn't dirty."

### THE S&L SCANDAL

In the mid-1980s, the Reagan administration was faced with another scandal, the savings and loan (S&L) debacle. Reagan believed in a *laissez-faire* government, which would let private enterprise expand with minimal government interference. Reagan wanted state and local governments to assume more responsibility for government programs, decreasing the power of the national government over the American people. This idea was labeled New Federalism; it was not very successful.

The savings and loan industry, prior to the Reagan administration, was heavily restricted in the types of loans that bankers could make. During the 1980s, the restrictions were taken off and extensive, unsound loans were made throughout the S&L industry. When the various banks went bankrupt, investors lost practically all of their money as the government insurance policy only covered \$100,000 their deposits. Reagan's belief in a free economy motivated him to remove the restrictions that had been placed on the lending policies of the S&L industry. Sixty percent of all the S&L failures at the time involved fraud. Some even involved the Central Intelligence Agency and organized crime laundering money, the sale of worthless junk bonds, and corrupt S&Ls trading properties on paper in order to fool auditors. There were also many bad loans made to real estate developers and foreign countries.

The administration's timid enforcers repeatedly blocked or slowed attempts by regulators in the field to clamp down on reckless S&Ls. Reagan's actions, which were designed to fuel the economy, unfortunately ultimately undermined the entire S&L industry. Reagan hoped to go back to a classical,



*A popular president, Reagan nevertheless "sleepwalked" through various scandals that compromised his presidency.*

free-enterprise, capitalist system. Often referred to as supply-side economics, Reagan anticipated decreasing or removing government regulation of industry and to cut both corporate and individual taxes. It was ideally planned that the lower amount of regulation and lower taxes would encourage both businesses and people to invest more and spend more.

### THE HUD SCANDAL

The Housing and Urban Development (HUD) scandal dealt with influence peddling in low-income housing program. The Reagan administration viewed federal housing programs as little more than welfare handouts, and would have preferred eliminating HUD from government completely. The Reagan budget slashed HUD staff from 16,000 to 11,000, as well as reduced federal housing subsidies over a period of years from \$26 billion to less than \$8 billion. HUD had been turned into "grab-bag"



for the politicians in the Reagan administration. They allegedly used the money, which was meant for the housing of the poor to further enrich themselves. Reagan administration officials and some of their friends were paid outrageous fees while acting as consultants to HUD. HUD funds were used as political ploys to obtain votes for Republican candidates. While it is a felony to use federal grant money for political purposes, while campaigning for New Jersey Republican Milicent Fenwick, Reagan said he would award HUD grants to New Jersey but only if Fenwick was elected.

### THE EPA SCANDAL

The Environmental Protection Agency (EPA) scandal occurred when the Reagan administration claimed executive privilege to withhold agency documents from Congressional committees. A House committee claimed that in 1983 that Theodore B. Olson, an assistant attorney general had given false and misleading testimony in a bitter dispute about Congressional access to EPA enforcement documents. It was a political fight concerning whether the Reagan administration was adequately enforcing hazardous waste cleanup provisions of the Superfund law. Critics contend Reagan opened acre upon acre of government land for commercial purposes and protected corporations that were dumping and poisoning the environment. Reagan watched out for commercial interests of big business to the detriment of the environmental interest. The large amount of money taken and used for personal use by the Reagan administration in both the HUD and the EPA was suspiciously criminal.

One leading interpretation of the Reagan era is Haynes Johnson's *Sleep Walking Through History*. This book argues that Reagan was a true believer in his conservative philosophy, but had a hands-off attitude when it came to supervising his subordinates. Idealism and cynicism, claims Johnson, motivated the admittedly zealous young men in the White House to conspire and force upon the president their newly discovered principles of economic truth. They seemed divided between a sincere belief that they were creating a better way and a simultaneous conscious pursuit of self-interest and greed. This idea of a "sleepwalking" approach to management style may be an effective way to understand how so many scandals occurred during the Reagan era.

The Reagan administration was certainly not unique in its legacy of scandals. Numerous public opinion polls revealed that a majority of Americans liked Reagan's personally, but disagreed with his policies, and were alarmed by the Reagan era scandals.

### SEE ALSO

HUD scandals; Boland Amendment; savings and loan fraud; Iran-Contra; North, Oliver.

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## real estate fraud

REAL ESTATE AND LAND swindles have been the dark side of the important American aspiration of property ownership for all. While some schemes seem to emphasize the opportunity to speculate, to get rich for little investment, others target the average homeowner with the vision of a vacation or retirement paradise. Fraudulent deals have ranged from vacation land in Maine which appears to be solid ground only in the winter, to promises of prosperity in land surrounding the Hoover dam near Las Vegas, Nevada.

All of these schemes seem minor compared to perhaps the original American land fraud: the Yazoo lands of western Georgia, (now comprising the states of Alabama and Mississippi.) In 1789, members of the Georgia legislature authorized the sale of more than 25 million acres to three land companies for \$237,580. Six years later they sold some 35 million acres to four more companies for \$500,000, basically given away land for 1-1/2 cents an acre. The land companies sold shares in the land back to legislators, who stood to profit when promoters sold to northern investors. One of the victims was Robert Morris, signer of the Declaration of Independence. Even after a new legislature was voted in and rescinded the deal, the land companies

continued to sell tracts to unsuspecting speculators in New England and the mid-Atlantic states. The problem passed to the U.S. government when Georgia ceded the land to the United States. Eventually, the Supreme Court found in favor of land holders, ruling that original land grants were valid contracts, and that the later attempt to rescind was in violation of constitutional protection of contracts. In 1814 shareholders were awarded \$4.7 million. One author characterized this as a decision that “the land had been originally stolen fair and square.”

## FRONTIER FRAUD

Western town-site fraud became synonymous with the frontier. Perhaps the earliest was Rolling Stone Colony, Minnesota territory in 1852, promoted by William Haddock. He advertised and promoted the town as a thriving metropolis with lecture hall, library, and hotel and actually sold land to some 400 buyers who attempted to find the site, only to be told that it was on Sioux land.

But on the frontier, the line between town booster and outright con could be a very thin one. Visionary and political maverick Ignatious Donnelly was forever linked to a land deal gone bad in the Minnesota territory in the 1850s. Donnelly himself moved to the community and produced a prospectus depicting a thriving new city with courthouse, churches, and stores. A newspaper, the *Nininger Daily Bugle*, was full of ads for all kinds of business. Like most good fiction, this one relied on the wealth of colorful detail, invoking the image of a prime lot “just west of the dry goods store on First Street.”

While Donnelly always maintained that Nininger was the beginning of a futuristic utopian community, after a monetary crash in 1857, he found himself as the only inhabitant and his enemies later depicted the entire affair as a classic swindle. “Every name and every business was entirely fictitious.” In fact, Donnelly later became famous for a book of fiction, which made the famous lost continent of Atlantis seem like a reality.

Although Donnelly may have been a true and well-meaning futurist caught in one of the 19th century’s frequent monetary crashes, some would argue that American railroads in the 19th century did much the same thing, promoting and selling farm land along their lines far west of known arable land. Meanwhile, town-site fraud and town-lot

jumping was more than common; it was ubiquitous in the new boomtowns of the mining west, communities where there was little established law. Land fraud, especially in the west is closely related to mining swindles, especially those involving salted mines. Both types of fraud relied on and elaborate prospectus, the promise of outsized profits, and fast-talking salespeople.

## CLASSIC FLORIDA FRAUD

The classic American real estate swindle is the great Florida land boom of the 1920s. At its height, in 1925-26, more than \$7 billion changed hands. Whole communities platted on maps, described in detail prospectuses, and pictured in colorful brochures, but never built, lured northerners with promises of low down-payments and low monthly payments. While Charlie Ort developed Key Largo City, Kenneth Roberts planned Wyldewood Park near Ft. Lauderdale, erecting a sign, “Million dollar hotel to be built here,” and unloading the surrounding property at highly inflated prices.

The Mizner Brothers, Addison and Wilson, became the symbols of this boom, planning the most extravagant communities and promoting them with the most extravagant promises. Their El Camino Real was to be the broadest highway in the world, leading to their new Mecca, Boca Raton, Florida. While still awaiting construction of the grand canal, investors were induced to purchase expensive lots in the exclusive new community. In what was afterward seen to be a classic bubble, the prices skyrocketed. Addison Mizner himself offered \$50,000 to buy back a lot he had previously sold, but owner Lytle Hull would not sell for \$100,000. After the bust, the lot was worth only \$200.

One con led inevitably to another, and to promote his land, Mizner once buried some gold doubloons in Boca Raton harbor and generated much publicity when they later found “pirate gold.” Ort, not to be outdone, buried a crock of gold at Key Largo Sands. This first Florida boom victimized mostly the wealthy and upper middle class, but ironically, the Florida land in Boca Raton did become valuable, though many decades later. When land prices recovered after World War II, it led only to another boom, this one targeting retirees.

Land frauds did not end with town site frauds, or with real estate bubbles like the Florida land boom. In fact, with the advent of the internet, a



*Both the financing and construction of homes can be subject to real estate fraud and scams.*

whole new generation of real estate swindles are being perpetrated every day.

#### A NEW CRIME WAVE

In December 2003, the Internal Revenue Service (IRS) reported the booming real estate market helped increase mortgage fraud and other phony real estate related schemes. The perpetrators of these schemes ranged from mortgage brokers looking to make a fast buck to drug dealers laundering illegal revenues. "Every year, these fraudulent schemes victimize individuals and businesses from many walks of life, including struggling low-income families lured into home loans they cannot afford, legitimate lenders saddled with over-inflated mortgages, and honest real estate investors fleeced out of their investment dollars."

Through federal tax fraud investigations and money-laundering charges, the IRS is trying to fight real estate fraud. The number of real estate fraud investigations initiated by IRS Criminal Investigation (CI) doubled from 2001 to 2003. Similarly, the average prison term handed out by federal judges to defendants in these schemes nearly doubled over the same period (from 24 months in 2001 to 46 months in 2003). Some of the more common real estate fraud schemes cited by the IRS include:

*Land flipping:* A buyer pays a low price for property, then resells it quickly for a much higher price. While this may be legal, when it involves false statements to the lender, it is not.

*Two sets of settlement statements:* One settlement statement is prepared and provided to the seller accurately reflecting the true selling price of the property. A second fraudulent statement is given to the lender showing a highly inflated purported selling price. The lender provides a loan in excess of the property value, and after the loans are settled, the proceeds are divided among the conspirators.

*Fraudulent qualifications:* Real estate agents assist buyers who would not otherwise qualify by fabricating employment history or credit records.

In these real estate fraud cases, money laundering is often the mechanism used to hide income from the government. Money laundering is the process of attempting to make money earned illegally appear to be legitimate. The IRS says many criminal tax investigations focus on money laundering schemes because it is often inseparable from tax evasion.

#### A FEW CASES

Two convictions from the IRS case files help illustrate some of the more recent scams:



*The settlement of the vast American plains was replete with town-site fraud and deceptive advertising.*

On August 18, 2003, in Greenbelt, Maryland, Alton F. Bivins was sentenced to 57 months in prison, three years of supervised release and ordered to pay restitution of \$297,188. As the loan officer for the First Capital Acceptance Corporation and Mortgage Corporation of Maryland, Bivins assisted his sister, Karen Bivins, and Donald Osorio in spending their drug proceeds to purchase real estate. As the loan officer, Alton Bivins submitted false loan applications and documentation, including false tax records and false employment verification, to obtain the mortgage loans. The drug proceeds of Osorio and Karen Bivins were used for down payments and closing costs to complete the transactions. The properties involved were valued at over \$1.1 million.

On September 17, 2003, in Des Moines, Iowa, Steven Tod Davis was sentenced to 37 months in prison on bank fraud and money laundering charges. Davis was also ordered to serve five-years supervised release, fined \$10,000 and ordered to pay restitution of \$1,860,403.50. At his plea, Davis said he formed a company called Eastgate Development to purchase and develop a 40-acre parcel of land in Ames, Iowa. The land was to be developed into commercial lots for resale. During November and December 1997, he raised a total of \$1.2 million from 24 investors, each of whom contributed about \$50,000 for the purchase of the land. Davis further admitted that in May 1998, he obtained a \$1.8 million line of credit from the First National Bank, and in June of 1999 obtained a \$1.5 million line of credit from the Hardin County Savings Bank. He explained to both financial institutions that the purpose of the loans was to develop the infrastructure of the property. Davis said he used about \$1.8 million of the loan money for purposes other than developing the property, including using the money for his own personal use and injecting funds into other business ventures. He also admitted that he used \$300,000 of the money to make a payment on a jet aircraft loan with another financial institution.

#### SEE ALSO

bank fraud; forgery; scams; savings and loan fraud; contractor fraud.

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## redlining

THE TERM *redlining* originated in the insurance industry where insurance executives would draw a red line around a neighborhood to be excluded or treated differently. Defined as the refusal or an inequality of service to a specific geographic region based upon income and/or race, it has been common in the banking and insurance industries. Banks practice redlining when they refuse to accept checks over a certain amount from customers, or when they assign disproportionately higher loan costs, interest rates, loans greater than real value, loans with no regard to borrower's income, loan/property flipping, balloon payments, or negative amortization. Neighborhoods where such practices are commonplace can become devastated by loss of equity and mortgage foreclosure.

The disparity of loan refusals between whites and minorities has been on a steady rise. African-Americans are twice as likely to be turned down for loans when compared to white applicants of similar circumstances. Latinos are one-and-a-half times more likely to be turned down compared to white applicants. And residents, regardless of race, in low-income areas are three times more likely to be turned down as those in upper-income areas when applying for a conventional mortgage. But even when income is held constant, racial redlining is still present.

For example, upper-income African Americans are more likely to be denied a loan or mortgage than middle-income whites. Legislation passed to curb the practice of redlining includes Home Ownership Protection Act (HOEPA), the Community Reinvestment Act (CRA), and the Home Mortgage Disclosure Act (HMDA).

Insurance companies, on the other hand, are not regulated by the laws of Congress but by the states. The states have mostly left laws that govern the practice of insurance sales largely unenforced.

Because of this, it is hard to obtain data needed to calculate and plot the depth and seriousness of insurance redlining.

In the late 1990s and early 2000s, technological advances brought a new type of redlining called electronic redlining. Electronic redlining is defined as the refusal of broadband, high-speed internet access to a poor and/or minority neighborhood. In 2002, a lawsuit was filed against AT&T for discriminatory practices in favoring white neighborhoods.

Redlining is not exclusive to the United States. For example, in South Africa, with its unique history, this is an especially prevalent problem. Since the country is still recovering from a long period of apartheid, there are generations of animosity and hostility along racial lines. The South African Parliament attempted to introduce the Community Reinvestment Bill that would prohibit redlining. But after stiff opposition from the banking community and lobbyists, the bill was withdrawn for further consideration. In 2002, the Banking Council agreed that it is not feasible or acceptable to issue loans to "anarchic" areas. On the other hand, in areas where this is not the case, it is not acceptable to refuse lending based on race or income.

#### SEE ALSO

insurance fraud; racial discrimination; Consumer Product Safety Commission Act.

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## reform and regulation

EARLY SCHOLARS of white-collar crime, including Edwin Sutherland, recognized that the dominant legal response to crimes by businesses was regulatory rather than penal. Regulatory enforcement occurs in only a very small percentage of the

cases in which it could be applied, and it has far less of the moral outrage and stigma associated with the criminal justice system. The regulatory justice system has a lower profile and is less likely to involve an adversarial confrontation between two parties than the criminal and civil justice systems.

Regulation has been very broadly defined as any attempt by the government to control the behavior of citizens, corporations, or sub-governments, but there is no real consensus on its meaning. Regulation typically involves the imposition of official standards and rules on some form of productive human activity, and it includes an enforcement mechanism and some type of sanctions. It can involve rate-setting, licensing, and financial disclosure requirements, among other stipulations.

A distinction is often made between economic regulation, which addresses market relations (for example, securities, antitrust matters, interstate commerce) and attempts to ensure stability in this realm, and social (or protective) regulation, which addresses harmful consequences to workers, consumers, and citizens of productive activities. Although significant interaction occurs between these two forms of regulation, the social form in particular has expanded greatly since the early 1970s. Because social or protective regulation is much less likely than economic regulation to serve business interests and involves an inherent conflict between the regulator and the regulated, it is met with far more resistance from business interests. Social regulation typically arises following a crisis, tragedy, or panic over some industrial condition or practice. In response to public pressure, the government reluctantly develops regulatory agencies and rules, which the affected industry initially resists and then lobbies to limit in scope. Regulatory laws and enforcement practices are often weak at the outset but may become more potent over time.

#### MODELS OF REGULATION

There is no single theory or model of regulation. One approach views regulation primarily as a rational means of protecting the public interest. A second, economic approach to regulation emphasizes a cost/benefit analysis oriented toward efficiency. (Although this perspective does not necessarily address the important question of how costs and benefits are defined). A third approach is essentially political; it views regulation primarily in

terms of competing interests and the extension of power. Neo-Marxist versions of a political approach to regulation see it as a mechanism for maintaining elites' power and privileges; in this view regulated agencies are dominated by the industries they are supposed to regulate.

## AMERICAN REGULATION

The American experience with regulation has been one of ongoing tension between calls for more and calls for less regulation of a wide range of activities. Regulatory and deregulatory cycles have occurred throughout U.S. history. The first major period of federal regulatory expansion in the 20th century occurred during the Progressive Era (1900-14), when populist sentiments against the abuses of big business became sufficiently intense to promote significant government intervention in harmful corporate and occupational activities on behalf of the public interest. In reality, however, much of the regulation developed during this period was supported by and benefited the newly regulated big businesses. For example, the implementation of the Pure Food and Drug Act (1906) that exposed the horrendous conditions in meatpacking plants clearly benefited the larger meat producers by promoting consumer confidence in "government inspected" meat while smaller meatpacking firms that were unable to absorb the added cost of regulation frequently went out of business.

A second major period of regulatory initiatives occurred during the New Deal Era of the 1930s, at least in part inspired by the belief that the 1929 stock market crash and the economic Depression that followed had resulted from unregulated abuses by financiers and major corporations. In an effort to re-establish confidence in failed banks and in the stock market, the Federal Home Loan Bank Board (FHLBB), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), and the National Labor Relations Board (NLRB) were established during this period. These agencies were granted considerable autonomy, although this hardly made them immune to either political pressures or lobbying by corporate and business interests.

A third, major period of expanding federal regulation began in the relatively affluent Great Society Era of the 1960s and early 1970s. The predominantly social regulation of this time was responsive

to a growing awareness of, and organized protest by consumers, environmentalists, and workers against harmful corporate activities. The Consumer Product Safety Commission (CPSC), the Environmental Protection Agency (EPA), the Occupational Safety and Health Administration (OSHA), and the Mining Enforcement and Safety Administration were all established between 1970 and 1973. These agencies operate under more direct control of the Executive branch than is true of the New Deal agencies, and they tend to be more directly responsive to the political agenda of the incumbent administration.

A reasonably high level of consensus on the desirability of government regulation in many new areas eroded in the second half of the 1970s. This period of deterioration of the economy (including rising inflation and declines in industrial productivity and U.S. competitiveness abroad) enabled critics of government regulation to advance much more effectively the argument that federal regulation had become oppressive and economically harmful.

## COSTS AND BENEFITS

In 1980, Ronald Reagan ran for president on a platform that was highly critical of a bloated government, and his election was a major factor in the deregulatory era of the 1980s. During this decade regulation was scaled back or severely constrained in many areas (for example, consumer protection and antitrust), especially when politically dominated agencies were able to act on a discretionary basis.

The general tendency in an expanding and increasingly complex society is for regulation to grow. An ongoing debate centers on the moral rightness, desirability, and expedience of such regulation, whether there is currently too much or too little regulation, and whether specific regulatory statutes, agencies, policies, and actions are or are not defensible. Opponents of regulation have claimed that it is an infringement on the individual's freedom and economic rights; that at least some of the regulated activity (for example, insider trading) is essentially victimless; that regulation is economically inefficient; and that alternative processes exist for dealing with harmful activities that are organizationally and more efficient than regulation, and incorporate greater accountability and due process.

More specifically, governmental regulation has been accused of stifling innovation, accelerating

inflation, increasing unemployment, and decreasing international competitiveness.

The direct costs of regulation have increased exponentially since the early 1970s, and industries and businesses frequently complain about the excessive paperwork and cost (\$100 billion in 1980) involved in compliance. Social or protective regulation was especially criticized as unreasonable, contradictory, counterproductive, and administered by self-interested regulatory bureaucracies.

The accurate measurement of the costs and benefits of regulation is complex. Various parties have incentives to inflate costs or conceal benefits, and there is no single way of interpreting either costs or benefits. It is especially difficult to measure some long-term benefits of regulation, particularly in matters of health, safety, and environmental protection.

Furthermore, there is no complete consensus on regulatory purposes and goals. A leftist or progressive critique has argued that the principal objective of regulatory agencies in a capitalist society is to maintain broad popular legitimacy of the system which is accomplished by adopting regulation that only symbolizes governmental oversight, because regulatory agency effectiveness is severely limited by inadequate budgets and pro-industry regulatory board members who develop specific rules that favor industry interests.

Proponents of regulation contend that it is absolutely necessary in a complex society in which anticompetitive forces with economically undesirable consequences can develop unless the state intervenes, because individuals and communities don't have the means to protect themselves from a wide range of directly harmful or threatening corporate and business activities. Furthermore, corporations have an uncommon measure of power in shaping perceptions of risks, because the capabilities of assessing both risk-related information and realistic options for self-protection are not equally distributed in society. Defenders of regulation argue that factors ranging from bad management to declining markets, not the great expansion of federal regulation in the 1970s, were the principal causes of the economic distress of that period.

In this view, businesses actually benefit from federal regulation because without it they would likely face a much greater number of conflicting state regulations and more civil suits from workers, consumers, and citizens. Even if such regulation

cannot be shown to pay in terms of short-term market efficiency, other interests, such as protecting workers and the environment, should take precedence. Many polls reveal general public support for regulatory protection, especially in health, safety, and environmental matters. Altogether, the pro-regulatory argument holds that this activity prevents and deters much activity that could be labeled white-collar crime, and that in its absence, much harm occurs.

## REGULATORY AGENCIES

Federal regulatory agencies are created by Congressional action, or specifically by an enabling statute. Some agencies are structured as executive branch departments, whereas others are set up as relatively independent entities, although it is not clear that the latter structure is less susceptible to political influence than the former.

Regulatory agencies are typically directed by a commission, the members of which are appointed by the president and subject to Congressional confirmation. Because they are political appointees, these top agency administrators generally serve only during the term of their presidential sponsor; the managerial personnel below them, however, are more often civil servants who work for the agency over an extended period of time. The managerial personnel of these agencies may be required to have appropriate technical expertise, although the degree of emphasis on expertise and the autonomy of the agency varies.

Regulatory agencies have three basic functions: rule-making, administration, and adjudication. Regulatory rule-making has been supported on the grounds that it allows for more flexible responses to developing circumstances and often requires specialized scientific or technical knowledge that resides in regulatory agencies. It also frees the Congress of the enormous burden of passing thousands of rules, and it diminishes the political consequences of unpopular or contested rules. On the other hand, the legislative oversight process for regulatory rule-making has become quite cumbersome, and it has been recognized that the rule-making process can be distorted by many political or other inappropriate considerations. Industry and business lobbying groups, for example, often succeed in delaying the implementation of new rules they find threatening to their interests.

In recent years federal regulatory agencies have been issuing as many as 7,000 rules and regulations annually, as compared with some 300 public laws enacted annually by Congress. Many of these regulatory rules are relatively minor. In contrast to criminal laws, regulatory rules are likely to be more ambiguous, tend to focus on the risk (not the occurrence) of harm, and are geared toward liability, not criminal intent.

The investigatory process of regulatory agencies typically involves a mixture of reactive and proactive strategies; more visible offenses (especially those involving formal complaints) generally take priority over the more complex, costly proactive investigations in which agencies take the initiative. Violations come to the attention of regulatory agencies from many sources, including consumer complaints, government investigations, Congressional committee investigations, business competitors, the media, and employees.

When it is determined that hearings are appropriate, regulatory agencies can act quite informally in many circumstances without observing due-process guidelines. A fairly large body of law, codified in a basic way by the Administrative Procedures Act (APA) in 1946, governs formal agency proceedings. Agency hearings most typically take the form of quasi-criminal proceedings and are less formal than regular court hearings and trials.

Such hearings are presided over by an administrative judge or hearing examiner, who is independent of agency personnel. Defendants can have attorneys, but they are not entitled to a jury trial. Administrative judges and hearing examiners are empowered to impose various orders or sanctions on defendants, including cease-and-desist orders (equivalent to injunctions); special orders (for example, directives intended to correct past conduct, or product recalls); consent orders (negotiations regarding certain actions); summary orders (for example, prevention of the sale of food); and license suspension or revocation.

Administrative agencies can impose some direct sanctions or civil fines. Cases may also be referred for criminal action or may lead to civil suits. Appeals from hearing decisions must first go through an internal agency appeal process and only then are eligible for appellate court review, although appellate courts have typically been reluctant to overturn agency decisions. When agency decisions are overturned, the basis for such reversals is likely to be a

determination that the decision was fundamentally arbitrary, capricious, or discriminatory; was not based on substantial evidence; violated applicable constitutional safeguards; or exceeded the statutory authority of the agency.

Regulatory enforcement and decision-making styles vary greatly in terms of regulatory philosophy, regulatory officials' assessment of compliance and noncompliance, and the actions officials take when they identify violations. Many cases are dropped because it is impractical to pursue them further; cases that are pursued may be dealt with by administrative action, civil action, or referral for criminal prosecution. In the 1970s in particular, federal regulatory agencies seemed more willing to support the application of criminal sanctions.

Regulatory agencies confront a basic choice between emphasizing compliance (persuasion and cooperation) or deterrence (prosecution and punishment). In one conceptual scheme, regulatory agencies extend along a continuum from non-enforcers (who engage in cooperative fostering of self-regulation) to rulebook enforcers (who emphasize command and control). In another scheme, four regulatory agency policing styles have been characterized as service, watchman, legalistic, and free agent.

The first two styles favor persuasion; the service style displays greater proactive initiative and technical competence than the watchman style, which is industry dominated and reactive. The legalistic and free agent styles are prosecutorial, but the legalistic is more mechanistic and formal, whereas the free agent style is more informal and autonomous.

Regulatory agencies adopt some mixture of cooperative and punitive approaches. Informality and bargaining, and a norm of accommodation, take precedence over the strict implementation of legal rules for most regulatory agencies. Still, the degree to which cooperative versus punitive strategies should be adopted has been heatedly debated. Many different interacting factors shape regulatory enforcement styles.

These factors include the technical, economic, and legal problems encountered in regulatory implementation; features of the "task environment" (for example, detectability); and the political environment of the regulatory agency. Regulatory laws vary considerably in their stringency and specificity, and the objectives they are promoting in the pursuit of curbing white-collar crime.



## REGULATION AND INDUSTRY

Politics is often a potent element in the regulatory agency appointment process, at least in the higher levels of agency staffing. Perhaps unsurprisingly, the ideological commitments of agency administrators apparently have important impacts on agency policies and practices.

If, on the one hand, regulatory agencies have been criticized as too responsive to a political agenda, they have also been criticized on the grounds that they are run by appointed bureaucrats with too much power, too little competence, and too little accountability. On the competence issue, it has been claimed that because government salaries cannot generally compete effectively with private sector salaries, regulatory agencies (especially in lower-level jobs) disproportionately attract individuals with mediocre qualifications. Industry representatives claim that this leads to inefficient, even absurd, over-regulation, whereas critics of industry claim that regulatory personnel are too easily misled and tend to under-regulate.

It is commonly conceded that regulatory agencies are greatly under-staffed and under-funded, given their responsibilities. Public pressure for agency action is small relative to that for conventional crime, and business interests have traditionally lobbied for various limitations on agency powers and budgets. OSHA, for example, has several hundred inspectors with responsibilities relating to several million businesses; the SEC has an annual budget in the tens of millions of dollars to police financial transactions in the hundreds of billions of dollars. These agencies increasingly rely on computers to uncover illegal activities, but this use of computer technology raises concern about excessive government intrusion and invasion of privacy.

Even though small businesses may indeed be intimidated by government regulatory agencies, there is good reason to believe that the larger corporations often have an advantage over regulatory agencies. In view of the enormous economic consequences of many regulatory actions, the potential and the reality of corruption are ever-present on all levels. Corruption may be direct or indirect, ranging from outright bribes to prospects of post-government-service jobs with lucrative salaries. The meat industry provides the salaries for inspectors, and this arrangement (however cost-effective for the

government) is obviously conducive to corruption. Regulatory personnel may also be compromised by their subservience to powerful political officials, who may in turn put pressure on them on behalf of corporate and individual benefactors. This pattern was exemplified in the Keating Five case involving five prominent U.S. Senators who pressured thrift regulators on behalf of Charles Keating, the head of a major thrift who had donated heavily to their political campaigns.

## AGENCY CAPTURE

The concept of agency capture—signified by close and cooperative relationships with regulated industries—has been one part of the critique of regulatory agencies, although there has been considerable disagreement about whether it is appropriately applied to contemporary regulatory agencies. There is no single definition of the agency capture concept, and it has been variously applied to situations when little disruption of industry profits occurs; when the level of regulation is minimal and acceptable to industry; and when enforcement of regulatory law is lenient. More specifically, suspicions of agency capture occur when regulatory agency officials with a pro-industry bias are appointed (or when such officials can anticipate lucrative private-industry perks following their government service), and when various forms of inducement or influence, political or psychological, are evident. Other observers have argued that agency capture cannot simply be equated with corruption and does not necessarily lead to corruption.

Some of the typical criteria for identifying agency capture have been criticized. Industry interests are not necessarily unified or in conflict with public interests, although non-industry interests may not be adequately represented within regulatory agencies. Regulatory agency policies that may appear to signify capture may instead reflect a distaste for confrontation and a view of social welfare shared by the regulators and the regulated alike.

Despite such reservations about the notion of agency capture, regulatory agencies (for example, the EPA and the FDIC) have, in various instances, been co-opted by the industries or businesses they are supposed to be regulating. Since at least the 1970s, a number of policies and strategies have been adopted to minimize the chances of agency capture, including prohibiting entry into regulated indus-

tries for a significant period of time after regulatory agency service, limiting agency discretion with more specific statutes, and professionalizing agency personnel. Such measures may have diminished but have not eliminated the problem of agency capture.

Altogether, regulatory agencies often find themselves contending with countervailing pro-regulatory and anti-regulatory forces, and as a matter of survival they may have to steer a middle course between these forces. A complex mix of factors, ranging from political pressures to professional pride to greed, are involved in the regulatory process.

### SELF-REGULATION

One manifestation of government regulation of business is the notion of self-regulation, or private policing directed at one's own company or professional peers. Self-regulation generally distinguishes white-collar crime from conventional crime; that is conventional criminals are not typically expected to police or regulate their own illegal conduct. Self-regulation is important because government does not even begin to have either the resources or the expertise to police or regulate fully all the activities of corporations, retail businesses, professionals, and legitimate white- and blue-collar entrepreneurs.

Many corporate crimes are instigated or inspired by the highest levels of authority in the corporation, and obviously these executives are unlikely to encourage any investigation of such activity. On various levels, however, corporate executives may cultivate "concerted" or "strategic" ignorance of certain specific, culpable actions as a way of protecting themselves (and the corporation as a whole) from criminal charges. White-collar crime lawyers advise top executives to avoid involving themselves too directly in internal investigations, when allegations of corporate wrongdoing arise, as a way of minimizing the executives' exposure in any subsequent prosecution. Thus, the chief executives may discourage self-policing or distance themselves from any self-policing inquiries.

On the other hand, corporations often expend resources to police themselves because: 1) they are not uniformly indifferent to an ethical obligation to do so; 2) they have a powerful self-interest in maintaining a good public reputation; and 3) they want whenever possible to pre-empt the imposition of the less palatable alternative of governmental regulation.

### SEE ALSO

regulatory enforcement; Securities and Exchange Commission; Environmental Protection Agency; Keating Five; compliance programs.

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## regulatory enforcement

EDWIN SUTHERLAND, the noted sociologist who coined the term *white-collar crime*, observed that not only were the criminal activities of business persons less likely to be subject to criminal penalties, but the corporate and business person was likely to be subject to less severe penalties imposed by a regulatory agency. The use of regulatory agencies and administrative measures to punish white-collar criminals is the most marked distinction between white-collar and other criminals. The involvement of agencies other than the police underlines these distinctions.

The term, *regulation*, generally used to describe the structure of law, enforcement, and sanctions surrounding most offenses, is accompanied by different language from that used in conventional crimes. Fraud and financial offenses are more readily regarded as criminal, subject to criminal law and sanctions and more likely to be subject to police investigations.

Laws are enforced by a variety of enforcement agencies, whose main role is the maintenance of standards and public protection. What is often called social regulation is therefore associated with a distinct set of laws and procedures and regulations. Many scholars have distinguished activities that threaten the interests of capital as fraud and theft and ultimately are likely to be subject to

stronger criminalization than those that do not threaten the pursuit of profitability.

Traditionally, criminal justice scholars assumed the less severe nature of white-collar crime reflected the influence of high-status and powerful offenders. More recently, scholars have found it difficult to substantiate direct class bias in the regulatory enforcement of white-collar crimes. Others also dispute that regulation is less stringent, arguing instead that the differences between white-collar and other crimes necessitate different laws and enforcement. In turn, however, these arguments have been strongly criticized for accepting the ideological distinction between white-collar crimes and other crimes. Regulation has been subject to considerable research, theorizing, and academic and political discussion. Studies in the sociology of law have examined the nature and development of regulatory law along with the activities of enforcers and the role of class and powers. Discussions have also focused on the most appropriate means of preventing white-collar crime.

## HISTORICAL CONTEXT

Regulatory enforcement can be appreciated more clearly by understanding its historical context, which involves the tension between free market, *laissez-faire* principles under which legal intervention is resisted, and liberal, welfare values under which legal intervention is justified as necessary for public protection.

To advocates of free-market principles, intervention is seen as unnecessary because market forces can themselves ensure high standards of production and protect the public. Workers, it is argued, will refuse to work in unsafe workplaces and consumers will avoid buying substandard or unsafe goods. On the other hand, industrial development has continually presented dangers that have not been prevented by market forces. Protective legislation has been premised on an assumed need to strike a balance between the interests of public protection and industrial or commercial development and profitability.

The aims of regulatory laws and agencies tend to stress the need to secure a fair balance between the interests of business, industry, or commerce and those of consumers, workers, or the general public. Moreover, regulators' main aim is said to be to protect the public by encouraging high standards

of trading or commerce, with the detection and prosecution of offenses being one among many strategies. Regulatory agencies are not seen as, nor do they see themselves as industrial police officers but as expert advisers or consultants whose aim is to secure compliance to laws and regulations.

Particular legal problems have also surrounded the criminal liability of companies. It is often very difficult to establish that corporations are legally liable. Considerable difficulties surround establishing intent, or *mens rea*, along with the recklessness or gross negligence, where companies rather than individuals are involved because corporations are legal abstractions and have no "soul" or "mind."

One of the most immediate features of white-collar law enforcement is the large number of different agencies involved. Providing a full list of these would be a prohibitive task. However, these agencies have a number of common characteristics. Principal among these common characteristics is the tendency of most agencies to see prosecution as a last resort, reserved for a relatively small proportion of detected offenses. This is particularly true in the area of social regulation, where only a small number of complaints and incidents eventually lead to prosecution.

## COMPLIANCE PROGRAMS

The lack of prosecutions is attributed to the use of what are described as compliance strategies, which are most often associated with social regulation but also, apply to financial regulatory bodies. These derive from the nature of regulatory law, which produces a situation in which an agency's main role is seen to be the maintenance of high standards and compliance with regulations. Many agencies pursue advisory and educational roles in which visits or inspections are used to offer expert advice as well as to detect violations.

Enforcement officers and businesses are involved in a continuing relationship in which persuasion is seen to be a better means of encouraging cooperation and compliance. It is often argued that a strict prosecutorial approach would damage this relationship and alienate businesses. When offenses are detected, a typical approach is to persuade businesses to remedy the situation before resorting to formal measures. These measures range from verbal advice, warnings, and cautions to more formal written notices requiring improvements, and official

cautions. Prosecution is considered only if those options fail and offenses persist.

Compliance strategies are also related to the range of powers possessed by agencies, many of which are seen as more effective, and on occasion more Draconian, than prosecution. Some agencies have powers to grant or withdraw licenses necessary for a business to operate, and others can close a business, particularly where it poses a direct danger to public health or where previous warnings have been ignored. These powers are considerable because they directly threaten the profitability or survival of a business, although they are often used sparingly. Other regulatory bodies have powers to disqualify company directors, and professional bodies can also “strike off” or otherwise disqualify members. Some agencies can, additionally, negotiate out of court financial settlements and impose financial penalties. In companies, individual offenders may be dismissed rather than prosecuted because companies may fear that publicity could damage their public reputation. Many offenders are therefore dealt with and sanctioned without resort to criminal proceedings.

Many of these strategies are based on considerations of cost-effectiveness. In addition to being seen as less appropriate, prosecution may be avoided on the grounds that it is costly and often risky. Many offenses are complex in nature, which makes them difficult and costly to investigate, detect, and prosecute. These investigations involve time and resources. Serious frauds are particularly costly to investigate because they often involve many participants and have taken place over long periods of time. They may also require the collection and examination of a long paper chain of thousands of documents or interviews with many witnesses, many of whom may be located abroad. These problems are exacerbated where prosecution is contemplated because evidence must be carefully prepared to satisfy legal requirements that are often complex. Trials have gained the reputation of being risky. Therefore, agencies balance the time and costs of protection in less serious regulatory cases with the lower costs of persuasive strategies, especially where a small fine may result from a prosecution.

The low rates of prosecution inevitably raise questions about which offenses and offenders are most likely to be prosecuted, particularly in relation to class bias. Regulatory enforcement was subject to considerable research in the 1970s and 1980s, in

which the attitudes and day-to-day practices of enforcement agents were studied to explore the relationship between the “law in books” and “law in action.” These studies revealed how the tension between prosecutions and persuasion are played out in practice and variations between and within agencies. These studies largely confirmed that, in general terms, prosecution was reserved for cases with high public profit. Judgments were made about the character of the criminal.

## PROSECUTIONS AND CRITICISMS

Enforcers also have stereotypes about types of businesses where offenses are most likely to occur. This leads to some businesses being visited more often and being seen as deserving prosecution. These studies found no conclusive evidence of class bias, however this issue must be placed in the wider political and economic context of business regulation.

The nature and practice of regulatory enforcement have been subject to extensive public and academic debate. The effectiveness of regulatory enforcement has been questioned and the low rate of prosecutions is said to be an insufficient deterrent, although to advocates of free market principles the same rates of prosecution can be seen as excessive. It is seen to constitute favorable treatment for one class of offenders, which raises questions about the fairness and impartiality of criminal law and justice. At the same time, however, the extent to which it does constitute lenient or unfair treatment can be questioned, and it can also be argued that the regulatory approach is necessitated because offenses are more difficult to detect and prosecute than other crimes along with the rationales for regulatory enforcement. These different views are linked to alternative approaches to the reform of regulation.

Criticisms of ineffectiveness have been leveled at both financial and social regulation, although financial regulation attracts stronger public reaction. Financial regulators are often criticized for the length of time required to take actions in fraud cases. Some high-profile cases have also attracted critical attention to social regulation. The failure to prosecute companies for corporate manslaughter following mass deaths and injuries has led to considerable public and academic criticism, and also draws attention to the policies of enforcement agencies. If the threat of prosecution is to be seen as a

deterrent, it is argued, it should be a real one, and the widespread use of out-of-court settlements (meaning many offenders are not publicly prosecuted), compounds these problems.

Although allegations of direct class bias are difficult to substantiate, it can nonetheless be argued that higher-status offenders are structurally advantaged. In general terms, the outcome of compliance strategies is that white-collar offenders, who are more often of middle-class status, are less likely to be prosecuted than conventional offenders and it is also the case that some, often more respectable or large businesses, are less likely to be targeted for surveillance or prosecution.

The use of negotiated settlements can also be seen as advantageous, because, irrespective of their effectiveness, they result in fewer prosecutions and may lead to a situation in which wealthy offenders can "buy" themselves out of public prosecution, which carries a greater stigma. Some offenders may also be able to exert political pressure in relation to investigation and prosecution, as has been the case where the investigation of serious fraud has been subject to political intervention.

In addition, although the law, particularly in relation to social regulation, is seen primarily as a deterrent, the criminal law also carries implications of moral disapproval and its legitimacy rests on assumptions of equal treatment. Therefore, whether or not prosecution is cost effective, it is justifiable on moral grounds. Moreover, arguments about the cost-effectiveness of prosecution are applied less to conventional offenders. It could be argued, for example, that it is not particularly cost-effective to prosecute a burglar in that it may not compensate victims, stop the individual from burgling, or deter other burglars, yet few would dispute that burglars should be prosecuted.

The rationale for compliance strategies therefore rests on assumptions that differentiate white-collar offenses and offenders from other offenders. In addition to pointing to the complexity, organizational location, and invisibility of offenses which hamper law enforcement, advocates of compliance strategies make a number of assumptions about offenders. It has been argued, for example, that white-collar and particularly organizational offenders differ from conventional offenders because their activities are socially productive and should not be curtailed, and that they are not recalcitrant criminals but law-abiding citizens who are amenable to

persuasion. Offenses are seen to be a result of incompetence or lack of expertise rather than criminal or deliberate intent, and as incidental rather than central to the operations of the business. Businesses can be persuaded to comply because, ultimately, offending is not in their long-term interests, despite being motivated by short-term desires to avoid the costs of regulation. Corporations are seen as being capable of being socially responsible and are not therefore necessarily only amoral calculators.

These assumptions have been contested by those adopting a Marxist approach, who relate white-collar crime to capitalism and the profit motive. To such critics, regulation must be located in the political and economic structure of capitalism. In particular, the Marxists challenged the contention that businesses are not amoral calculators. Although individual managers and corporations claim to be socially responsible, they nonetheless have a legal responsibility to act in the interests of shareholders and are continually under pressure from shareholders and competitive considerations to maximize profits at all costs.

These pressures necessarily push managers to develop an amoral, calculative attitude to economic activity, to try to act as rational economic actors. Moreover, Marxists argue, the assumption that businesses are persuadable is related to a view that illegalities are marginal to business operations, which accept business rationalizations and is contradicted by the widespread and normal nature of law violations.

The regulation of white-collar crime therefore involves complex issues. The debates and analyses surrounding regulation and cooperative or compliance models, which have dominated the study of white-collar law enforcement, tend to focus on the contrast between policing crime and regulating business.

#### SEE ALSO

prosecution; compliance programs; reform and regulations; Securities and Exchange Commission; Environmental Protection Agency.

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## religious fraud

FROM JOSEPH SMITH, who founded Mormonism after a revelation that still brings charges of a hoax to L. Ron Hubbard and the lawsuit-prone Scientologists, religion and fraud have been inextricably mixed, either as fact or in the perception of non-believers and skeptics. As religion has become more lucrative and media coverage has expanded, the frauds have as well. The particular type of fraud, the huckstering televangelist, peaked in the 1980s. But other sorts of fraud persist. Fraud against the religious can take the form of affinity fraud. And virtually every religion has those who claim that its origins are fraudulent. Further, there are frauds outside organized religion, in the New Age movement, and elsewhere. Finally, frauds arise from true belief: pious fraud.

The 19th century was a time of religious ferment. The Second Great Awakening emphasized the personal religious experience and potential perfectibility. New religions arose, as did new philosophies and reform movements. Mormonism came into being in New York, and millennial cults and utopian communities were scattered across the country. Reform movements such as temperance and abolitionism had religious underpinnings. At the same time, the United States began to commercialize its entertainments, and religion changed to meet the competition from cheap literature and theater and other amusements.

People who wanted to believe were susceptible to charlatans and frauds, who arose as the purveying of religion became profitable. Late in the century the personal religion mixed with science to create pseudoscientific cults such as spiritualism and

brought into being such sects as the Christian Scientists, Seventh Day Adventists, and Jehovah's Witnesses.

Initially, the new commercial religion was free of fraud, and tent and early radio evangelists prospered greatly. From Dwight Moody to Billy Sunday to Father Divine, the charismatic evangelists kept their business dealings legitimate. By the time of Aimee Semple McPherson in the 1920s through the 1930s, the lines were beginning to blur. The evangelists became able to bring in incredible amounts of money through media pitches and the sales of questionable goods.

Effective use of radio and mass solicitation, and the switch from free public access to paid time after the 1960s, meant that evangelists needed more money and had fewer Federal Communications Commission (FCC) restraints on their television programming. The televangelists became looser, more flamboyant, more aggressive in marketing. The crash of the televangelists in the early 1980s would not diminish fraud.

## THE 19TH CENTURY

The Church of Jesus Christ of Latter Day Saints, the Mormons, was created in the 1820s when Joseph Smith, Jr., was visited by supernatural creatures, including the Angel Moroni who revealed to Smith the existence of a set of golden plates. Using "magic" spectacles, Smith translated the tablets into the Book of Mormon. Those who regard the story as fraudulent note that Smith had a reputation for telling stories and pulling pranks. He also was a treasure hunter with a "magic stone." And he did have one conviction of disorderly conduct as well, and an 1826 appearance in court on charges of fraud. Smith was accused of fraud, forgery of the book and the tablets, and eventually bank notes. He attempted faith healing, laying on of hands, but reportedly failed.

Christian Science practiced faith healing. Even today, Christian Science rejects modern medicine, preferring a laying on of hands and the healing power of God to cure sickness. Christian Science was founded by Mary Baker Eddy in 1879 on the work of Phineas Parkhurst Quimby who called it the Science of Man. Critics note that Eddy was a heavy abuser of morphine and was a believer in mesmerism. She also supposedly copied or plagiarized Quimby's writings.

In 1884, Charles T. Russell founded the Zion's Watch Tower Tract Society, the Jehovah's Witnesses. Russell had frequent occasions to defend himself on charges of swindling. And he ran afoul of the U.S. government, which debunked his "miracle wheat," as but another of his money-making schemes. Russell also perjured himself in a 1912 libel suit by exaggerating his academic credentials and his knowledge of biblical languages. Apparently, he also lacked ministerial standing in any church other than the one he created.

Spiritualism was also popular in the 1870s and 1880s. At the end of the century, spiritualists were anticipating the millennium and the onset of a utopian New Age. Spiritualists believed in angels and trance-channeling as a means of communicating with the deceased by way of mediums. The spirit table-rapping medium had its origins in upstate New York in 1848 with Margaretta and Kate Fox, who claimed that spirits communicated by rapping tables. Thirty years later, the Fox sisters confessed that they produced the rapping by cracking their toe knuckles. By then, there were tens of thousands of mediums holding séances where objects materialized or levitated and the "spirits" made noises of communication. In the 1920s, Harry Houdini, the escape artist, spent considerable time looking for a legitimate medium, but he found none. Spiritualism remains the belief of many people into the 21st century.

## THE 20TH CENTURY

The courts opened the floodgates in 1925 by ruling in *Hygrade Provision Co. v. Sherman* that only intentional fraud was punishable. Good faith, even if in false belief, was sufficient defense. The 1944 case of *United States v. Ballard* affirmed that sincerity was a matter for juries to decide, but truth of belief was not.

The sea change came in the 1930s with radio evangelism, which could reach numbers unimagined by the tent revivalists. The technology changed, but the grift was the same: play on emotions such as fear, anger, passion and induce mass hysteria and rake in the money. Among the most notable of the era was McPherson, the first evangelist to broadcast a sermon. She wore long white gowns, flowers in her hair, and passion in her voice. She eschewed coin, so she hung a clothesline over the believers' heads so they could pin bills and she

could reel them in. She was buried with a telephone in her coffin so she could call if God resurrected her.

The radio evangelists were generally more staid. More typical was Father Charles Coughlin, who made his money fighting the left rather than skinning the gullible. The big scams came after World War II, with the switch from radio to television.

## TELEVANGELISTS

By definition, the televangelist is a minister, commonly fundamentalist or evangelical Protestant, whose ministry may include a congregation in a physical building but the largest number of whose followers are in a radio or television audience. The prototype was the Catholic Coughlin, anti-communist and eventually anti-New Deal, in the 1930s. Televangelists may or may not be officially ordained. Televangelists may or may not be honest or orthodox. They may practice pseudosciences such as faith healing, or they may be straight frauds. The unscrupulous may provide false promises in return for donations from the gullible. Or they may embezzle or divert funds to personal use.

The televangelism phenomenon boomed and culminated in the 1980s when 45 million "born again" Christians spent \$1 billion a year on religious literature and music, and supported 5,000 evangelical schools. The revival tent gave way to the mass revival in the domed stadium, the regular program over one of the four fundamentalist networks broadcasting around the clock. The United States had 1,400 all-gospel radio stations and 30 gospel television stations. And the political clout of the born-again showed in the 1980 Washington for Jesus demonstration that brought 200,000 to the capital. Their political power was evident in the electoral defeats of Senators Dick Clark of Iowa and Thomas McIntyre of New Hampshire who ran afoul of the born-again, and in the rewriting of public school books. Religion was a huge phenomenon, a gold mine for those who chose to fleece the flock.

The scams of 1978–79 included James Roy Whitby of Oklahoma who swindled an elderly widow out of \$25,000 in 1978, and in 1979 was charged with selling \$4 million in worthless bonds. One of his associates in the second case, the Reverend Tillman Sherron Jackson, had been involved in the 1973 the Baptist Foundation of America case,

whose \$26 million fraud led to a 1973 Congressional inquiry. The case ended in acquittals.

Garner Ted Armstrong raked in \$75 million a year from the Worldwide Church of God, run by Garner Ted and his father, Herbert W. Followers sometimes donated 30 percent of their incomes to allow Garner to live royally until 1976 when followers protested the son's sexual habits and the father's self-enrichment. Later, the church leaders faced charges of embezzlement and pilfering. The believers had little to show for the upward of \$1 billion they had given over the years.

LeRoy Jenkins of South Carolina brought in \$3 million a year from selling prayer cloths, healing t-shirts, and miracle water to viewers on 67 television stations. Even after he went to prison for conspiracy to burn the homes of a state trooper and a creditor and to mug a newspaperman, his staff continued to broadcast his taped revival program.

Praise the Lord (PTL) grossed over \$50 million at its peak. The Justice Department wanted to look at its books and the FCC had suspicions that the PTL was engaging in fraud and misleading appeals, as it begged for money to save the overseas missions and the PTL itself. Meanwhile its leader, Jim Bakker, and his wife Tammy, were spending extravagantly. One station mockingly referred to PTL as the Pass the Loot club.

The Reverend Hakeem Abdul Rasheed (alias Clifford Jones) and a female associate went to jail for mail fraud in California in 1980 after running a Ponzi scheme, where new donors' contributions paid the old members, with enough left over for the minister. Ponzi schemes are pyramids that inevitably crumble when the requirement for new donors becomes overwhelming.

False claims that its \$15.95 Cross of Lourdes product was dipped in a "miracle pool" and had a Papal blessing cost American Consumer Inc. a fine of \$25,000 in 1979 for 1,000 counts of mail fraud. The company also refunded \$103,000.

Consumer Companies of America was a 20-state chain founded by the Front Brothers Gospel Quartet. For \$535, believers bought merchandise and the right to sign up others, receiving commissions on their orders in the manner of Amway and other companies. After living generously, the brothers were convicted of stock violations, sued for fraud, and hit with a tax lien of \$370,000. The pyramid scheme collapsed in 1979, and losses were widespread. Embezzlement was the crime of the

Reverend Jerry Duckett of Williamson Church of God in West Virginia, who stole \$40,000 from the church building fund.

Jim Jones's People's Temple required members to donate 40 percent of their income and sign over savings accounts, insurance policies, homes, and Social Security and welfare checks. Jones staged phony cancer cures using stooges and sleight of hand removal of chicken gizzard "tumors." Two disillusioned former members revealed Jones' fakery to *New West* magazine. Jones and 900 followers went to Guyana and died, most committing suicide in a paranoid frenzy. People's Temple assets totaling over \$13 million were found afterward.

In the early 1970s, A.A. Allen maintained the tent tradition, adding jars of embalmed bodies he said were demons he had removed from the sick (skeptics said they were frogs). His "love offerings" reached \$2.7 million a year. He died of alcoholism, and was the one who supposedly said, "When you can turn people on their head and shake them and no money falls out, then you know God's saying 'Move on, son.'"

The Reverend James Eugene Ewing of Los Angeles, California, solicited donations with promises of Cadillacs and other material wealth. He had believers mailing pledges through "God's Gold Book Plan for Financial Blessings." His gross was \$4 million a year until a 1977 bankruptcy.

The Reverend Guido John Carcich of the Pallottine Fathers in Baltimore, Maryland, embezzled \$2.2 million. He was convicted in 1978. Only 3 percent of the \$20 million the group collected reached the "starving, sick, and naked." Carcich told workers in his warehouse to discard prayer requests without money. His sentence was a year as a prison counselor.

In 1973, Rex Humbard's ongoing attempt to sell \$12 million worth of "gospel bonds" ran up against a Securities and Exchange Commission (SEC) cease-and-desist order because the commission concluded that Humbard lacked the assets, even though he had a multimillion dollar real estate holding. Humbard begged for donations, and the believers gave, until the millions were sufficient to satisfy the SEC.

In 1979, Julie Titchbourne won a \$2 million verdict against the Church of Scientology after the church fraudulently claimed it could increase her I.Q. And Los Angeles jazz guitarist Gabor Szabo sued the church for embezzling \$15,000 from him,



kidnapping him, and forcing him to spend \$12,000 on a "life repair course."

L. Ron Hubbard, founder of Scientology, suffered a French fraud conviction in 1979, and Scientology had a 1980s investigation of charges that it had obtained millions of dollars through fraudulent bank loans.

The top 12 money-makers as of 1980, the heyday of televangelism, grossed a total of between \$400 and \$425 million, with Garner Ted Armstrong's *The World Tomorrow* leading with \$75 million. Evangelists do not have to disclose their assets because evangelistic enterprises are churches and exempt. Congressman Mark Hatfield and others tried in 1977 to enact disclosure legislation, but it failed. In 1979, Billy Graham led three dozen other revivalists in creating the Evangelical Council for Financial Accountability, and the Better Business Bureau cited 50 ministries that fell below its ethical standards. The FCC used fraud-by-wire law interpretation in ruling that it was illegal to ask for money for one purpose but spend it for another, and the FCC had the power to pull licenses or not renew them. State attorneys general occasionally attempt to cite consumer protection statutes against the televangelists. And the Internal Revenue Service watches excess salaries and expenses and possessions, but not to any great extent.

## THE BUBBLE BURSTS

What finally broke the televangelism bubble was excess and scandal in the mid-1980s, particularly the shenanigans of Jim Bakker. Between 1984 and 1987, Bakker and his associates at the PTL Club offered lift-time partnerships to pay for the building of Heritage USA, a Christian resort and activity center in Fort Mill, South Carolina. Donors, known as Lifetime Partners, received free lodging at the resort on a space-available basis. Unfortunately, the demand exceeded the supply, and regular paying guests had priority for lodging. Accusers said the organization deliberately underbuilt and that they oversold—that constituted a fraud. Convicted and sentenced to 45 years in prison, Bakker served almost 5 years before his 1993 parole. Bakker also had to resign from the PTL in 1987 because of his scandalous affair with Jessica Hahn.

Peter Popoff had a lucrative career in faith healing. Claiming that God healed through his hands, Popoff cured illnesses through a laying on of

hands—touching and healing through God's miracles. In the 1980s, James Randi and Johnny Carson exposed Popoff on national television, costing Popoff popularity and audience. Popoff used an in-ear radio to get messages from his wife off-stage as she read cards that the audience filled out beforehand. His ministry went through bankruptcy in 1987.

Over 70 percent Mormon, Utah has a long history of hosting scams. In 1984, one estimate was that 75 percent of the country's investment scams originated in the Salt Lake-Provo area. Fifteen years earlier, Salt Lake City already had the attention of the *Wall Street Journal* as "a locus for shell operations." And the *Journal* anointed Salt Lake City the stock fraud capital. Again, in 1984 the label stuck, this time in *Newsweek*. Even with the publicity, the fraud continued into the 1990s. Presumably the Mormons were victimizing themselves through their absolute loyalty to the church, their willingness to accept any recommendation by another Mormon. Hucksters brought church officials, perhaps unknowingly, into their scams. Utah's governor, Scott Matheson, established a securities task force in 1984 to fight the Mormon connection. His task force included a prominent Mormon, Hugh Pinnock, member of the General Authorities since 1977. By 1985, reportedly the Mormon people were wiser. However, not long after that Pinnock got conned into signing a loan to buy non-existent documents. The Mormons were long vulnerable to document fraud; this one cost \$185,000. The wiser people of the fraud capital had begun preying on each other. In the 1980s, fraud cost 10,000 Utah investors over \$200 million.

## TURN OF THE MILLENNIUM

The televangelists took the people by giving them hope; 20 years later, the racket was simply a matter of taking the people and giving them nothing in the manner established in Utah decades before. In Arizona in 2001, the Baptist Foundation of Arizona offered a good return of 6.7 percent on investments. It attracted Baptists by using sales people who seemed to share their values. Then it went bankrupt and three of its officials pled guilty to fraud. More than 13,000 investors lost \$590 million through a case of affinity fraud.

The 1990s and after were a time when increasingly sophisticated investment rackets used reli-



*Religious fraud often involves raising millions of dollars in the name of pious efforts, only to see the believers' money end up in the minister's bank account, paying for a lavish lifestyle.*

gious loyalty to bring in the believers' money. And it was a national problem, continuing despite the frequent exposure and the common-sense reminders from securities officials that investment and faith were better kept separate. Between 1998 and 2001, affinity fraud cases involving over 90,000 investors spanned 27 states. Another case, the \$448 million fraud of Greater Ministries International Church, based in Tampa, Florida, ended with Gerald Payne, an ailing, 65-year-old minister sentenced to 27 years in prison on fraud charges, having bilked 20,000 believers who had to mortgage homes, cash in retirement funds, or run up credit card debt for the promise of large returns on investments in mines and cargo ships.

In 2001, the Philip Kronzer Foundation for Religious Research sued three national groups based in New Jersey, Alabama, and Indiana for fraudulently using phony Papal indulgences and visions of the Virgin Mary to conceal tax evasion, smuggling, and money-laundering. Purportedly the Alabama-based Caritas organization and leader Terry Co-

lafrancesco used mind control and false promises as well as other deceptions to bilk Californians through the internet. The other groups sued were the Children of Medjugorje of South Bend, Indiana, and the Children of War, of New Jersey.

In Bosnia, in 2003, the contributions of believers in the miracle of the Blessed Virgin Mary of Medjugorje were given to the local Franciscans, who, through various companies and a sympathetic bank, were financing a Bosnian Croat nationalist, that is, terrorist group. The Franciscans controlled the shrine, which since 1981 drew millions of pilgrims and brought in the money of millions of other Catholics and Protestants. This case included both cult abuse and religious fraud. And those who chose not to reveal the fraud were willing to use violence against investigators and reporters.

In 2002, a Utah jury found the True and Living Church of Jesus Christ of the Saints of the Last Days guilty of failure to produce Jesus Christ in the flesh. The leaders had to pay nearly \$300,000 to two victims for breach of contract, fraud, and emo-

tional distress. The jury rejected claims of racketeering and unjust enrichment. The church had required the victims to provide property in return for other unnamed property, membership in a heavenly elite, and the aforesaid meeting with Jesus. The church split from the Mormons in 1994 over the issue of polygamy. Another phenomenon was the revival of the late 19th century mix of loose science and religion in the New Age movement. A typical case occurred in California when two psychics swindled clients, charging thousands of dollars to rid the sufferers of their bad karma. The federal term for it is mail fraud. The investigation revealed that one man with bad karma went for a tarot card reading after a romantic disappointment in 1996. The “psychics” convinced him to participate in ever more expensive sessions, culminating in an all night gathering of psychics costing \$750,000. Before that, in the three years he believed, he had given over \$500,000 as well as possessions. Only after watching a television program on psychic fraud, did the man investigate the psychics and turn away from them.

## INTERNATIONAL FRAUD

The American way of fraud spread overseas. A cult fraud in Japan in 2000 had members believing that the leaders could cure disease by examining the people's soles. The foot diagnostic cost believers hundreds of thousands of dollars. And, in Taiwan in 1996, Sung Chi-li was accused of selling believers phony photos of him performing supernatural acts. Convicted of fraud, his case was overturned on appeal in 2003 when the high court ruled that the constitution protected religion and there was no proof that he didn't have supernatural powers. This ruling was consistent with U.S. law that truth or falsity was not subject to jury scrutiny but sincerity was. Good faith made fraud unintentional and not actionable.

Belief also allowed the perpetration of frauds such as psychic surgery. Psychic surgery is actually not surgery and it's performed by a non-surgeon. The healer creates a psychic or fake incision by running a finger along the patient's body, penetrating the skin through magic or faith. The healer takes something from the patient's insides, either a tumor or a chicken liver, depending on the perspective. Blood squirts from a hand-hidden balloon. The surgeon closes the psychic incision, and the patient goes to either live or die. Psychic surgery is more common in Brazil and the Philippines, but one pop-

ular practitioner, Tony Agpaoa of the Philippines, was indicted in the United States in 1967 for fraud. He fled, forfeiting a \$25,000 bond. Psychic healing “works” because patients have faith in the healers. And, at least some of the healers believe their methods work—rather than fakes, they are pious healers, instruments of God or Christ. Among these is Stephen Turoff of England, also noted for the therapeutic touch, a laying on of hands. Psychic dentistry is also popular, most notably Willard Fuller who has healed over 40,000 people since 1960.

Pious frauds let excess religious zeal lead them into deception. Various stigmatics, those who have seemingly inexplicable bloody wounds mimicking those of the crucified Jesus, have been accused of being frauds, including Sister Lucia dos Santos of Fatima (1917), who claimed that she and two others had a visitation from the Virgin Mary. Although she is suspected of having been hallucinating or under the influence of religious books, she has maintained a cult following from the 1940s, and Fatima in Portugal is a site of prayer, penance, and money donations.

A 21st-century alleged pious fraud is Catalina Rivas of Mexico, who has the stigmata wounds and claims to receive messages from Jesus, Mary, and angels in Latin, Greek, Polish, and Spanish. She also channels books through automatic writing, going into a trance and letting the spirits guide her hand as it writes.

As long as people believe and as long as believers have money and as long as religious freedom includes the right to collect money in the name of God, fraud will flourish.

## SEE ALSO

Bakker, Jim and Tammy; wire fraud; mail fraud; United States; tax evasion.

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## research fraud

SCIENCE IS ALWAYS in motion and falsification is an inseparable and even constituent part of science (as Karl Raimund Popper and others pointed out). Research fraud can be divided into at least four major groups: 1) false titles or non-existing publications; 2) plagiarism; 3) forged material, invented experiments and non-existing or exaggerated research results; and 4) pseudo-science.

False titles or nonexistent publications are probably the most basic case of research fraud, whereby the results could be harmful for society, but are usually not for science itself. Forged diplomas of real universities, or awards from fake educational entities are increasingly commonplace. Anybody with access to the internet and a laser printer can create reasonable facsimiles of awards and diplomas.

Some forgers believe careers may be accelerated by such gimmicks. The more dangerous cases involve medical doctors actually operating on real-life patients without any proper training to do so. It should be pointed out that such cases usually only have success outside the scientific community, when the title or degree is not checked against the actual knowledge of the person bearing (or boasting) the title.

Nonexistent publications in a professional background list may open the door to a scientific career, but will sooner or later end abruptly when somebody searches for the publication or a new paper is required from the swindler. Examples range from a student-employee at Harvard University forging letters of recommendation, to a scientist at Stanford University quoting from his own articles, which were never written or published.

Plagiarism is probably the most common case of research fraud. Since the invention of the internet, some students write their school or college papers with the "help" of publications in the public domain. Plagiarism in its crude form, that is the total copy of a paper or article and just changing the name of the author, is easily detected. More sophisticated cases like partial use from several sources, or the paraphrasing of one source are more problematic. The line between plagiarism and cumulative scientific writing is always thin, but the borderline is crossed when sources are not quoted at all or are downplayed in significance. Plagiarism is not just a recent phenomenon, but modern information technology has facilitated new forms of plagiarism; conversely, the same technology allows for easier and quicker detection of plagiarism.

Forged research materials, invented experiments, and nonexistent or exaggerated research results are usually the most important threat to science itself, as other (innocent) scientists may come to wrong conclusions following up false leads based on faked results. The danger is usually most acute when the forger holds a high position within the scientific community. These forgeries are sometimes hard to detect as the replication of fraudulent experiments may involve big laboratory facilities and major funding. Sometimes minor changes in small numbers may signify success or failure of an experiment, so one replication at another laboratory may not be enough to prove fraud beyond a reasonable doubt.

Examples of this kind of research fraud include Ptolemy, who "invented" measurements he never did, and Isaac Newton, who brightened up some of his results to improve its prognostic efficiency. John Dalton's atomic theory was fundamental to nuclear science, yet some of the experiments he described seem to be singularities, if they ever happened at all the way he claimed. In 1912, fossils found in Piltown made Great Britain the birthplace of humanity, unfortunately all were forgeries.

Three Indian "scientists" forged microscope pictures in 1961, and in a more recent case, a German physicist nearly ruined the longstanding fame of Bell Laboratories by making up research results on a large scale. Biomedicine and cancer research are at the cutting edge of science and are especially vulnerable to fraud.

Pseudo-science is a threat to the uneducated public, not to the scientific community itself. Fraud

is inherent to certain forms of self-appointed “scientific” areas like parapsychology, astrology, or UFO research. Whereas some questions within these fields are asked by serious scientists, a large percentage of the publications covering these subjects use a “scientific” language, but invent their basic materials and neglect every aspect of a methodological scientific approach.

### TOTALITARIAN SCIENCE

It has to be pointed out that totalitarian regimes tend to hinder science (extending up to frauds to avoid unpleasant new results) or even to create fields of pseudo-science. The best example is Nazi Germany, where Rassenlehre (race science according to the Nazi ideology) led to such strange things as *Arische* or *Deutsche Physik* (Aryan or German physics), whereby the racially motivated refutation of Einstein’s theory of relativity was declared to be the guiding principle in “science.”

In the Soviet Union under Josef Stalin, biology was transformed by communist ideological preconditions. The Catholic Church, for many centuries and for ideological reasons, hindered the development of a modern astronomy (Galileo’s trial, for example). In the late 1980s, East German Communist Party chief Erich Honecker presented at one of his last meetings with Soviet leader Mikhail Gorbachev a certain microchip as the latest development of East German industry, which was, in fact, a dummy. In such cases, the fraud is not necessarily a product of one scientist, but comes from within the system itself and is enforced by the authorities with drastic measures (everything from funding shortages to a threat to the life of the opposing scientist).

Reasons for research fraud are to be found in personal misbehavior and vanity, but are probably better explained by the competition within the modern scientific community. This competition is for jobs and, even more importantly, for research funds. Although research fraud can never be excused for any reason, the modern financing system of science nevertheless has to bear part of the blame. As personal careers and sometimes sheer subsistence depends more and more on grants and short-term engagements instead of lifelong university or research jobs, the pressure to present better results comes with each grant or job application.

The countermeasures against research fraud are as simple in theory as they sometimes are difficult

to install in practice: Only an open scientific community presenting research results on an international basis is, at least in the long run, an effective safeguard against research fraud. Only if research results can be checked by other researchers and can be questioned in the case of serious doubt without any institutional or hierarchical hindrance, science then can detect, correct, research fraud. The framework must be set by criminal law and by self-regulations of scientific institutions or communities.

New dangers arise from events not linked to science in the first place. Competition between companies or national industries may enforce secrecy around new scientific results, as a safeguard against industrial espionage. New protective measures had to be taken after the terrorist attacks of September 11, 2001 in high-risk fields of science with potential dual-use-facility (parts of chemistry, biology, physics, etc.).

No one would question the legitimate desire to protect such research results or new technologies, which could be brutally abused if they fall into the hands of terrorists, but this new culture of secrecy for national security reasons may be the source for new dangers in the prevention of research fraud. Yet, as science is always work in progress, so is the prevention of research fraud.

### SEE ALSO

forgery; counterfeiting; healthcare fraud; Center for Science in the Public Interest.

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## *respondeat superior*

THE PRIMARY DOCTRINE by which organizations have been held legally responsible for their employees’ actions is taken from civil tort law, and is known as *respondeat superior* (let the superior re-

spond). The rule originated in England in the late 17th century (although it is traceable to more ancient times), and was meant to deter employers from escaping financial responsibility for the actions of their employees. *Respondeat superior* was first used in England in the mid-19th century to justify a criminal indictment, and it was first used for that purpose in America a short time later.

By the end of the 19th century, there was ample precedent to prosecute corporations under *respondeat superior*. Congress passed the Elkins Act in 1903, which outlawed shipper rebating and contained an explicit statutory clause for corporate criminal liability. Modern theories based on *respondeat superior* impose both civil and criminal liabilities on organizations. They are meant to force superiors to be vigilant of the behavior of people who work under them. *Respondeat superior* requires three elements: 1) the agent of the organization committed the crime; 2) while acting within the scope of his or her authority; 3) with an intent to benefit the corporation.

An organizational criminal liability that is different from *respondeat superior* is strict liability. Strict liability allows for the punishment of individuals and organizations who may not have intended to commit the illegal act. Most criminal statutes require that the perpetrator have an intention to commit the offense. However, strict-liability administrative civil and criminal penalties impose no requirement of intent on organizations or individuals. In essence, strict liability is blame without fault.

There are two basic purposes for imposing strict liability. First, strict liability supposedly encourages people to find out about the law, however obscure it may be, and to follow it. As in cases of *respondeat superior*, strict liability is supposed to act as a deterrent to a claim of non-responsibility for the offense, and it precludes corporate executives from purposely insulating themselves from knowledge of their employees' activities. The second major justification for strict liability is that it simplifies the prosecution of offenses because intent, which is potentially a very complex issue associated with behavior occurring within larger organizations, does not have to be proved. An organization is expected to know about wrongdoing within its ranks, and "should know" about it. Even accidental offenses, such as environmental or fair trade mishaps, are punishable by strict liability.

To exemplify the stringent legal precedents that have been established for corporate criminal liability, organizations are punishable when employees' collective actions constitute a crime, but each person's individual action does not. This model, known as collective intent or collective knowledge, imputes intent to an organization that never existed among its human actors. Unlike *respondeat superior*, liability for a collective intent offense is not vicarious because the crime arises only out of activities by a plurality of the organization's parts.

Until the 1960s, corporate criminal liability was generally limited to instances where higher level managers were directly involved in or willfully ignorant of the legal infraction. Throughout the 1970s and 1980s, organizational criminal liability was more stringently applied under strict liability and collective knowledge concepts.

However, the advent of the U.S. Sentencing Guidelines in 1991 limited criminal liability when there is non-involvement by higher-level personnel, and the existence of a compliance program to help prevent violations. This allows sophisticated organizations to shift the risks previously associated with *respondeat superior* onto lower-level "rogue" employees by blaming them for illegalities that occur, thereby insulating themselves from vicarious legal liability.

#### SEE ALSO

Sentencing Guidelines; corporate criminal liability; prosecution; employee crimes.

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## Revco

ON JULY 28, 1977, Revco Drug Stores, Inc., was found guilty of a computer-generated double-billing

scheme that defrauded the Ohio Department of Public Welfare out of \$500,000 in Medicaid funds. At the time, Revco was one of the largest drug retailers in the United States with 825 stores in 21 states.

This case was uncovered by accident in May 1976 when a pharmacist in one of Revco's Ohio stores was puzzled by the large number of prescriptions for narcotics and tranquilizers written by a local podiatrist. A vice president at Revco headquarters called the pharmacy board in support of a thorough inquiry; the pharmacy board contacted the Ohio Department of Public Welfare and by August 1976, the Revco records and the Public Welfare records for this podiatrist were being compared manually.

In October 1976, the investigation was expanded and by March 1977, a pattern of double-billing using transposed prescription numbers regardless of prescribing physician by multiple Revco outlets, was documented. The unraveling of this fraud involved a number of agencies and enormous effort due to the complexities of two different computer systems—Ohio Public Welfare and Revco. The intricacies read like a good mystery story. Revco finally revealed that a vice president and a program manager under his supervision decided to “make good” claims rejected by Ohio Public Welfare. They hired six clerks to alter the rejected claims—not by correcting them—but by double-billing with falsified prescription numbers to get money they felt the state of Ohio “owed” Revco.

Throughout this investigation, “Revco assumed the role of the victim, not the offender,” explains author Diane Vaughan in *Controlling Unlawful Organizational Behavior*. It is true that Revco's rate of claims rejections was higher than other providers (24 percent compared to 2 to 6 percent for other companies); Revco's solution was systematic fraud rather than the programmed pre-submission screening system suggested by the welfare department.

Vaughan mentions that the “maintenance of a reliable pre-submission edit system is expensive. Once installed, the provider's system requires constant adjustment as the information needed by the welfare department frequently changes. Allowable claims vary. Recipient eligibility requirements may be altered. New drugs on the market necessitate constant revision of the drug formulary.” Interestingly, the welfare department kept Revco as a Med-

icaid provider and, “the negotiations were concluded. Revco agreed to enter a plea of no contest to 10 counts of falsification, a misdemeanor of the first degree.

Under the organizational criminal liability statute, the prosecution would recommend imposition of the maximum fine of \$5,000 per count. [\$50,000]. In addition, Revco would make restitution in the amount of \$521,521.12 to the Ohio Department of Public Welfare. As for the two executives, each would plead no contest to two counts of falsification,” Vaughan reported. Later, Revco did institute pre-edits as required by the welfare department.

In 1997, a buyout by CVS drugstores was approved by the Federal Trade Commission. Revco systems were simply converted to CVS systems. This merger made CVS second only to Walgreen's in revenue in the drugstore industry. Now a big player, Revco paid \$4 million in 2001 to settle allegations of submitting false prescription claims to government health insurance groups.

#### SEE ALSO

Medicare and Medicaid fraud; healthcare fraud; pharmaceutical industry.

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## revolving door

THE EXPRESSION *revolving door* is applied to the flow of employees between the public and private sectors of the economy. Upon leaving their jobs, high level public officials are able to translate their expertise into equally prestigious and often higher

paying jobs in the private sector. The watchdog agency Common Cause defines the revolving door as “the practice of government officials cashing in on their public service by leaving public office and going to work for the same special interests who were seeking favors from them while they were in office.” Thus, this is an issue that raises important ethical questions because it breeds tight relationships between private sector organizations, bureaucrats, and elected officials that are perceived as threats to democratic government. The revolving door increases the likelihood that public officials will succumb to already pervasive incentives to accept kickbacks meant to sway official decision-making.

Common Cause led a 1989 effort to pass the Ethics in Government Act that applied post-employment laws to members of Congress. The subsequent one-year ban represented an effort to quell suspicion that moneyed interests wield a disproportionate amount of influence over the government decision-making process. Public servants departing from service in 1992 constituted the first group to face the one-year ban on assuming private sector positions requiring them to lobby former colleagues still in public service. According to an investigative article written by Jackie Calmes, of the 25 percent of the 435 House members who stepped down or suffered electoral defeat that year, approximately 40 percent landed positions lobbying or consulting after the one-year ban ended.

The effectiveness of the ban was challenged on the basis of the ease with which former public servants were still able to find a position after a year, and the fact that the ban does not prohibit them from devising strategies for clients during the year-long waiting period. Further, former public officials could and did gather with legislators socially.

At the beginning of the Bill Clinton administration, the president issued an executive order that extended the ban on federal government officials and White House staff from lobbying former colleagues to five years, and forever barred them from lobbying foreign governments. This move was seen as symbolic of the new Democratic administration’s commitment to clean government. As the Clinton administration waned, the president undermined the image of having run a clean administration when he revoked this order.

Common Cause keeps the public updated on the content of the most recent legislation in this

area. Under the existing law in 2004, high-level officials were prohibited from lobbying their own agency for one year. They were prohibited from lobbying on matters specific to the area that they supervised while in office for a period of two years. They faced a lifetime ban on ever lobbying on matters that they were personally and substantially involved in while in office. Former members of Congress were barred from lobbying other members for a period of one year. High-level members stepping down from the Congressional staff had to wait one year before lobbying the members who they worked for.

There are those who claim that the overall impact of the revolving door is positive, or at least not as harmful as opponents assert. Proponents of the revolving door argue that without it, private industry and interest groups would be at a disadvantage because the sheer volume of legislation that is passed poses a barrier to any individual or group being able to discern which decisions will directly impact them with enough time to actually lobby decision-makers. On the other side of the coin, interest groups provide a valuable service to government actors as well. Interest groups are a source of valuable information for decision-makers who need to consider the long-term impact of potential policy changes from a variety of perspectives within a limited amount of time in order to reach conclusions. Staunch opponents argue that the existence of a revolving door itself is enough of an incentive to ensure that government officials worried about their jobs after each election will rule in favor of powerful interests with a eye toward future employment and benefits.

#### SEE ALSO

government contract fraud; government procurement fraud; ethics; corruption; military-industrial complex.

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## Rich, Marc (1934–)

INDICTED FUGITIVE financier Marc Rich (a.k.a. Marc David Reich) was born in Belgium in 1934. His family fled the Nazis in 1942 and emigrated to America. Rich served his apprenticeship as a commodities trader under the tutelage of his millionaire father (a burlap-sack producer) and later, Philipp Brothers, a broker in raw metals. His tenure with Philipp Brothers taught Rich the dynamics of trading in natural resources with third world nations.

Rich's involvement with highly suspect business deals brought him to the attention of the U.S. federal government, and in the early 1980s, he was indicted for income tax fraud and breaking a U.S. embargo by selling oil to Iran during the hostage crisis. A criminal indictment was filed against Rich and his partner, Pincus Green, by U.S. Attorney Rudolph Giuliani in 1983. Rich and Green, however, fled the country for Switzerland before the pair could be brought to court to answer the charges. Both Rich and Green remained on the Most Wanted list of the Justice Department for 18 years.

That is, until January 20, 2001. A few hours before leaving office, President Bill Clinton fully pardoned Rich and Green, thereby nullifying the indictment against them. The presidential pardon was controversial because Rich had a long history of questionable transactions with third world nations and because Denise Rich, Rich's ex-wife, had lobbied hard for the pardon. The lobbying effort included donations of \$70,000 to Hillary Clinton's Senate campaign, several hundred thousand dollars to the Democratic Party, and \$450,000 to Clinton's presidential library. The president denied any connection between the lavish contributions and his decision to pardon Rich and Green. The U.S. Senate Judiciary Committee held hearings to review the legality of the pardon in February 14, 2001, but the results were inconclusive.

Rich had not returned to the United States since 1983. A billionaire commodities trader, Rich claimed citizenship status in Spain, Israel, and Switzerland, rejecting the idea that the United States has any jurisdiction over possible delinquent taxes while he resided there. The issue of citizenship is significant as it reflected both Rich's *modus operandi* in business and his philosophy toward the laws of other nations. He specialized in dealing with "outlawed" or dictatorial countries, regardless of world opinion, embargoes, and legal restraints.

Since 1979, Rich brokered deals in raw products to the following nations: Iran (oil and metals), Libya (oil), South Africa (oil), Cuba and Russia (sugar for oil), and Nigeria (oil). In an interesting turn of events, Rich used one of his American companies to secure 21 contracts with the U.S. mint. From roughly 1989 to 1992, Rich's firm supplied nickel, copper, and zinc to the U.S. mint to cast coins for distribution in the American economy.

Because he was pardoned by Clinton, Rich is not liable for prosecution in the United States for the original 1983 charges. It is possible that he could be held responsible in civil court for tax evasion if he were to return to the United States. Rich claimed that he denounced his American citizenship, but the matter remained unresolved.

As of 2004, Rich resided in Meggen, Switzerland, but the Swiss government has repeatedly refused to extradite him. Tax evasion is not a crime in Switzerland.

### SEE ALSO

tax evasion; Giuliani, Rudolph; Switzerland; prosecution; Clinton, William J.

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## risk analysis

THE SOCIETY for Risk Analysis defines risk analysis as "risk assessment, risk characterization, risk communication, risk management, and policy relating to risk." The risks being assessed and considered are, in this context, risks to human health from activities and agents as diverse as bioterrorism, neglecting to use sunscreen, working at a location where soil is contaminated, eating improperly stored food, and driving while intoxicated.

Risk is a measure of the probability of harm from a given activity or agent, often calculated as

the likelihood of one additional death per one million people. It is important to note that nothing is completely free of risk. The role of risk analysis is to measure and manage acceptable risks, not to eliminate harms completely.

Risk assessment is a statistical modeling technique that uses known exposures and harms to predict unknown exposures and harms. The Food Safety Risk Analysis Clearinghouse defines a four-step process of hazard identification, hazard characterization, exposure assessment, and risk characterization that is typical of risk assessment in general. At each stage, it is possible for false assumptions or misunderstood analysis to result in an incorrect assessment of risks.

Hazard identification involves discovering what potential causes of harm could be present in the substance or situation being assessed. Accurate hazard identification depends both on knowing what substances cause what harms and on knowing which of those substances is likely to be present. In West Chicago, Illinois, for example, homeowners used radioactive thorium tailings from an old American Potash plant as garden fill because they did not know that a hazardous substance was present. Many companies who are now responsible for contaminated site clean-ups aver that, although they knew they were dumping chemicals into the local groundwater, they did not know that the chemicals were harmful. Because hazard identification has become refined over the past 50 years, it is now a standard part of major property transactions to have include a document search, survey of aerial photos, and walk of the grounds, looking for signs of potential contamination. Similarly, the Environmental Protection Agency (EPA) is requiring chemical manufacturers to document the qualities of substances that have been manufactured and used for years but about which little is known.

## LONG-TERM HAZARDS

Hazard characterization focuses on evaluating potential adverse health effects from exposure. Two facts are at issue: whether any harms are caused and, if there is a harm, what dose causes it? Some hazards cause harms that only become visible many years later, making short-term health studies useless in characterizing the hazard. For example, asbestos in Georgia-Pacific's Ready-Mix joint compound caused a form of cancer that became apparent in

victims more than 20 years after exposure; hormones in a popular anti-miscarriage medication of the 1940s turned out to cause cancer in daughters whose mothers took the drug, with symptoms appearing only as the daughters reached their early 20s. In both of these cases, earlier studies had indicated possible health risks, but the studies were concealed or deemed inapplicable. Similarly, the Dalkon Shield contraceptive was marketed as safe based on a study that was too short to properly measure risks of pregnancy.

Exposure assessment measures how big a dose potential victims are likely to receive. The dangerous dose of a hazardous substance is often smaller for children, the elderly, or women than for adult males, due to lower body rate, lower resistance, or (for children) less developed nervous systems. The EPA thus demands a higher standard of clean-up if a contaminated site is to be used as a park for children than if it is to be used as a factory and parking garage, where most earth is covered with soil and most people exposed are adults.

Finally, risk characterization quantifies the risks to whole populations, given their qualities and exposure. This characterization is always based on assumptions; for example, the EPA's formula for calculating the risks to a child from contaminated soil assumes that a child will routinely consume or inhale a certain amount of dirt. If the contaminated area is paved over, the assumption no longer holds and the risk must be recalculated.

## POLITICS OF RISK ANALYSIS

Recalculating acceptable risks can become a political football put in play to prevent a company from having to reduce exposures. Thus, when the James River in Virginia became contaminated with the dangerous pesticide kepone, two governors at two different times petitioned the EPA to raise the acceptable level of kepone in fish for the good of the local fishing industry. (Both attempts were unsuccessful.) Industries routinely argue that the costs of reducing a risk are prohibitively high.

Acceptable levels of exposure can become political partly because risk analysis is always based on extrapolations from incomplete data and partly because the public usually misunderstands risk. While the Harvard Center for Risk Analysis quotes the Centers for Disease Control's findings that the annual risk of dying from alcohol is 9,000 times

greater than the annual risk of dying from bioterrorism, it is the lesser risk that dominates public attention. One factor that statistics cannot fully capture is that some risks feel more acceptable than others. The same person who eschews sunscreen in search of a golden tan (7,800 skin cancer deaths in the U.S. per year) may find it unacceptable to be exposed at work to a chemical that bears a considerably lower risk.

#### SEE ALSO

insurance fraud; Environmental Protection Agency; Justice, Department of; asbestos; kepone.

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## Rite Aid

RITE AID CORPORATION was founded by Alex Grass, who, beginning with a discount store in 1962, founded a chain that by 1995 was the number one drugstore chain in store numbers and second in sales. In May 1989, Alex Grass' son, Martin, was named president of Rite Aid. Rite Aid had purchased Lane Drug two months earlier, and the Ohio Pharmacy Board was dissatisfied with Rite Aid's intrusion into Ohio, and penalized Rite Aid for security violations in the Lane Drug deal.

Martin Grass met with Melvin Wilcznski, a member of the Ohio Pharmacy Board and offered him a bribe to resign from the board. Unknown to Grass, the police were videotaping the meeting at

Wilcznski's request. The judge dismissed the charges on the grounds that Ohio's bribery law covered bribes of public officials, but not bribes to resign public office. Grass countersued for defamation and won.

According to Frank Portnoy in his book, *Infectious Greed*, in 1996, when Rite Aid sold 189 stores for \$90 million profit, the company used the money to "absorb operating expenses." This \$90 million was a third of the total 1996 income and stockholders were told in the annual report that "gains from drugstore closing and dispositions were not significant." After that successful scheme, Rite Aid systematically overstated its profits by \$2.3 billion in all. The Securities and Exchange Commission (SEC) reported in 2002 that the fraud included "inflated revenues, reductions of previously recorded expenses, inflated deductions for damaged and outdated products, and unwarranted credits to various stores at the end of particular quarters."

The SEC charges included a new element: related-party transactions. Grass commingled Rite Aid accounts with other accounts to which he was a "related party" and used Rite Aid funds for personal debts. By 1999, Grass was inventing phony minutes to nonexistent meetings to support loan applications.

Where were Rite Aid's auditors? KPMG was their accounting firm and when they raised questions about irregular accounting practices, Grass threatened that "skeletons would come out of KPMG's closet" if they did not ignore the problematic issues. Grass also gave them an additional consulting contract to sweeten the deal.

Rite Aid paid Grass millions in options; at their peak, his options were estimated at \$100 million in value. Finally, in 2002, charges were brought against Rite Aid and Grass. While prosecutors were preparing their case, Grass and a company lawyer were taped fabricating testimony and discussing tampering with documents and destroying the computer that generated them. In 2003, the judge decided the tapes could be used at the trial. Rite Aid stock rose to \$50 a share in 1999 before collapsing. By May 2002, it was selling for less than \$2 a share.

When new management was brought into the company in 1999 to replace Grass, managers learned that Rite Aid had overstated profits in the late 1990s by \$1.6 billion dollars. "U.S. authorities alleged that Rite Aid's former management had orchestrated a massive accounting fraud that rivaled

the scandals that helped topple Enron Corporation,” reporter James F. Peltz wrote in the *Los Angeles Times*. Grass and four other Rite Aid officers were indicted on criminal charges in June 2002. In June 2003, Grass pleaded guilty to a conspiracy charge in exchange for “an eight-year prison sentence, a fine of \$500,200, and forfeiture of \$3 million in connection with a real estate deal. [He also] promised to testify against remaining defendants,” the Associated Press reported.

#### SEE ALSO

accounting fraud; Securities and Exchange Commission; Enron Corporation.

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## robber barons

ALTHOUGH WHITE-COLLAR crime and unethical business practices are certainly not unique to American companies, there is a prolifically fertile landscape for the roots of such behavior in the country’s indefatigable pursuit of capitalism, its unapologetic emphasis on success and the accumulation of material wealth, and the precedence set by America’s early capitalist tycoons.

Howard Abadinsky, one of America’s foremost scholars on organized crime, goes so far as to characterize the capitalist pioneers of the United States—men like John Jacob Astor, James Fisk, Leland Stanford, John D. Rockefeller, Cornelius Vanderbilt, and J. Pierpont Morgan, among others—as the “antecedents” to organized crime in the country. “While contemporary organized crime has its roots in Prohibition (1920 to 1933), unscrupulous American business entrepreneurs provided role models and created a climate conducive to its growth.” These so-called robber barons trans-



*John Jacob Astor, America’s first robber baron, made his fortune exploiting the fur trade with Native Americans.*

formed the wealth of the American frontier into vast financial empires, amassing their fortunes by monopolizing such essential industries as oil, railroads, liquor, cotton, and other textiles. In turn, these monopolies were built upon the liberal use of tactics that are today the hallmark of organized crime: intimidation, violence, corruption, conspiracies, and fraud.

Based partially on characterizations provided by Abadinsky, a description of some of America’s earliest tycoons, and the qualities that have earned them the label of robber baron, includes the following profiles.

John Jacob Astor (1763–1848), a fur magnate, amassed a fortune through the monopoly held by his American Fur Company over the trade in central and western United States during the first 30 years of the 19th century. This monopoly was achieved, in part, by crushing rivals and systemati-

cally cheating Native Americans of fur pelts. When his competitors complained to the government, Astor's agents resorted to violence. With his riches, Astor routinely paid off politicians to protect his business interests. At the time of his death, Astor was considered the richest person in the country.

James Fisk (1834–72) was one Wall Street's first great financiers, accumulating much of his fortunes by fraudulent stock market practices. Fisk invested much of the considerable money he made from smuggling Southern cotton to Northern mills during the Civil War into Confederate bonds. He then swindled European investors by selling short when the fall of the Confederate Army was imminent, but before Europe learned the Confederate currency had collapsed.

In 1866, he formed the brokerage firm Fisk and Belden, and the following year he and his colleagues protected their control over the Erie Railroad by issuing fraudulent stock. Along with his associates, Fisk attempted to corner the gold market by inflating the price, which was accomplished by bribing public officials to keep government gold off the market. The venture brought them vast sums but led to a securities market panic that began on September 24, 1869, a day that has long been remembered as Black Tuesday. At the time, the negative repercussions of the gold hoarding shook the economy and the scandal-plagued government of Ulysses S. Grant.

Leland Stanford (1852–93) became involved in Republican politics in California and was elected governor in 1861. While governor, Stanford approved millions of dollars in state grants for the construction of a transcontinental railroad line, during a period he was also president of the Central Pacific Railroad. With three colleagues, he formed the Pacific Association and used their combined assets to bribe Congressmen and others with political influence in the nation's capital. In return, the association was provided 9 million acres and a \$24 million loan financed by federal bonds.

In addition, Stanford and his associates intimidated local governments into providing millions of dollars in subsidies by threatening to have the rail line bypass their communities. In 1885, Stanford was elected to the U.S. Senate by the legislature and re-elected in 1890. In 1885 also, he established what would later become Stanford University. Stanford died in 1893 worth more than \$18 billion in 2004 dollars.

John D. Rockefeller (1839–1937) made his immense riches from monopolizing America's oil industry. Conspiring with refinery owners, he helped found what became known as the Standard Oil monopoly. In league with the railroads, the consortium had a stranglehold over the delivery of oil, forcing competitors to sell out to Standard Oil, or pay exorbitant shipping costs that would render them non-competitive. Those who were stubborn enough to resist were harassed with price wars, and if that did not work, dynamite. By 1890, the Rockefeller trust controlled approximately 90 percent of the petroleum production in the United States, a situation that led to the passage of the Sherman Antitrust Act that same year.

Some have argued that these early American capitalists created a business culture that places the importance of success, capital accumulation, and the realization of the American dream far above ethical behavior. Gus Tyler (1962) was one of the first writers to argue that the roots of organized and economic crime in the United States lie deep within the American culture, drawing nourishment from traditional virtues as well as the popularized vices and excesses of American civilization.

#### SEE ALSO

Rockefeller, John D.; Sherman Antitrust Act; antitrust; Stanford, Leland; organized crime; United States; capitalism; free trade.

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## Roberts, Oral (1918–)

EVANGELIST ORAL ROBERTS is considered by millions of Americans to be a prophet straight from God. Scores of other Americans, however, believe that Roberts is a silver-tongued crook who has bilked millions of dollars from an unsuspecting American public in the name of religion. Regardless of their perceptions of him, few would fail to

agree that Roberts has a knack for reading people and for using them to further his goal of becoming an internationally known evangelist. Roberts is the founder of Oral Roberts University chartered in 1963 in Tulsa, Oklahoma, which represents itself as a "Christian university with a liberal arts focus" and which is a major name in college basketball.

Roberts began his ministry in 1947. Over the course of the next several decades, he wrote over 100 books, amassing millions of dollars in profits. In 1979, Jerry Sholes, the son of a Presbyterian minister, who worked with the Roberts' operation for more than three years, wrote an exposé of Roberts and his empire. Sholes wrote that Roberts' representatives had offered him millions of dollars and a lucrative contract to write a book in support of Roberts rather than the exposé. When he refused, Sholes says that he was beaten to the point that he was forced to have plastic reconstructive surgery on his face.

The book offered a devastating look at Roberts who reportedly wore thousand-dollar Brioni suits and drove \$25,000 cars, replacing both every six months. Roberts' home in Tulsa was valued at \$250,000, and a second home in Palm Springs, California, was valued at over \$1 million. Sholes maintained that Roberts had photographers airbrush out his expensive jewelry so that he did not look too prosperous to his followers. While working for Roberts, Sholes attended a number of religious seminars where attendees were pressured to make donations from \$250 to \$100,000. The average take at the seminars, according to Sholes, was from \$1.5 million to \$3 million.

On September 7, 1977, Roberts announced to the world that God had sent him a vision in the desert telling him to build the City of Faith, a complex that would eventually include a hospital, a medical school, and a research center. The City of Faith opened its doors in 1981. Records show that Roberts had, in fact, discussed the City of Faith project with members of his staff months before he had the "vision." As much as 20 years earlier, Roberts had said in several interviews that he had already purchased land to build the City of Faith. The project was short-lived.

In March 1986, Roberts announced to his 1.6 million television followers that God had told him that if he did not raise \$8 million dollars by March 31, God would strike him down. A number of television stations around the country reacted to

Roberts' announcement by canceling their broadcasts of his shows. Reportedly, more than \$160,000 a day poured into the Roberts empire over the next few weeks. Roberts announced that when the devil entered his bedroom to strangle him, his wife Evelyn intervened. He then proclaimed that he had raised the necessary amount and that God would spare his life.

Before an audience of 6,000 followers at Oral Roberts University in July 1987, Roberts boasted that he could raise people from the dead. Ironically, Sholes tells a gripping story of the death of an infant child of one of the faculty members at Oral Roberts University who tried to pray his child into returning from the dead while Roberts refused to put in an appearance. Roberts followed his resurrection announcement by mailing out 1 million packets of "healing water" to his followers. Public reaction to Roberts' announcement was swift and negative, and Roberts' evangelical credibility fell drastically.

Between 1989 and 1990, Roberts laid off at least 10 percent of his staff. Despite his financial problems, Roberts offered \$6.5 million for Jim and Tammy Bakker's PTL television network in 1990 but was outbid by fellow evangelist Morris Cerullo, who bid \$52 million for the entire PTL unit. After turning over his religious empire to his son Richard, Roberts retired to his home in Palm Springs, California.

#### SEE ALSO

religious fraud; Bakker, Jim and Tammy; advertising fraud; embezzlement.

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## Robinson-Patman Act

THE ROBINSON-Patman Act (RPA) enacted in 1936 is part of the antitrust legislation found in the Clayton Act of 1914. It prohibits discrimination in pricing, promotional allowances, and advertising. Better known as the Anti-Chain-Store Act or Anti-Megastore Act, the RPA is designed to protect small businesses from being driven out of the marketplace by giant franchised companies. It is also intended to protect wholesalers from being excluded from the purchasing chain. Wholesalers do not want such franchises bypassing them to buy products directly from manufacturers.

The logic behind the RPA is simple: Large corporations and businesses receive substantial discounts from their wholesale suppliers. If smaller businesses do not receive the same discounts, they cannot offer the same products at competitive prices. Eventually, these small businesses will be forced out of the market. For example, a giant hardware depot locates itself in a city that has two similar, but smaller, stores. To acquire a controlling share of the market, the megastore continuously undercuts its two competitors by offering much lower prices on popular, high-volume items such as supplies and tools. The smaller businesses cannot match the advertised prices of their competitor because they cannot sustain persistent losses in their operating revenues.

This practice is referred to as predatory pricing. The megastore absorbs short-term losses as a necessary function of driving out its local competitors. The outcomes are twofold. First, area competitors are eliminated, thus securing the megastore's profit margin. Second, once the newcomer has increased its market power, prices are set at a higher level than before. In the long run, revenues are restored.

A retail monopoly-by-default may result as prices are inflated to recoup earlier losses. For the megastore management, predatory pricing resembles "aggressive marketing" in an intensely competitive environment. Price discrimination, however, may result in small business closures and bankruptcy filings.

Claims of price discrimination and predatory pricing are hard to prove. The RPA has ten basic requirements that must be established for an effective claim of discrimination. These include, among others, evidence of intent, interstate commerce, goods of "like grade and quality," and adverse effect(s) on

competition. As a result, the RPA is complex, difficult to apply, and open to multiple interpretations. Claims of price discrimination, for example, have been brought against booksellers, grocery store chains, agricultural co-operatives, and franchised retailers.

Litigation is typically brought by individuals and small businesses claiming predatory pricing and discrimination. Several aggressive defenses to the RPA exist, however, and include cost justification, meeting competition, truth in advertising, availability, and functional discounts. The Federal Trade Commission is responsible for upholding provisions of the RPA, but it is seldom enforced by the government.

### SEE ALSO

antitrust; Clayton Antitrust Act; Sherman Antitrust Act; predatory practices; price discrimination.

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## Rockefeller, John D. (1839–1937)

JOHN D. Rockefeller, founder of the Standard Oil Trust, was the archetypal robber baron of late 19th-century America. The label signalled public disapproval of the business methods and attitudes of Rockefeller and fellow industrialists and financiers such as Andrew Carnegie, William Vanderbilt, Jay Gould and J. Pierpont Morgan. Political demagogues and muck-raking journalists criticized Rockefeller and Standard Oil for colluding with railroad companies on freight rates, making covert company acquisitions, and predatory price-cutting or threatening to cut prices.

Rockefeller, born in Richford, New York on July 8, 1839, was the son of William Avery Rockefeller and Eliza Davison. His father was a travelling salesman dealing in horses, timber, salt, patent medicines, and herbal remedies, and was an occasional

money lender. The family moved several times during Rockefeller's childhood before settling in Cleveland, Ohio. Rockefeller attended Cleveland Central High School (1853–55) before studying business at Folsom's Commercial College.

On leaving Folsom's in 1855, Rockefeller took a job as a clerk and bookkeeper in Isaac Hewitt and Henry Tuttle's wholesale produce commission house. In the spring of 1859, Rockefeller left his first job because he was unhappy with his salary. He went into partnership with Maurice Clark to establish their own commission house after borrowing \$1,000 at 10 percent interest from his father. The new business flourished during the Civil War.

In 1863, Clark and Rockefeller entered the oil-refining business after forming a partnership with Samuel Andrews. Andrews had experience in oil refining and handled the technical operations, leaving finance, marketing, and distribution to Clark and Rockefeller. The new company Andrews, Clark & Company was a commercial success, owning and operating the largest oil refinery in Cleveland. In 1865 Rockefeller bought out Clark after a dispute over Rockefeller's expansion plans. Not long after the formation of Rockefeller & Andrews, Clark and Rockefeller dissolved their partnership. Rockefeller & Andrews proceeded to build a second refinery and formed a second company to handle marketing and distribution in New York.

In 1867, the company was renamed Rockefeller, Andrews & Flagler after Henry Flagler and Stephen Harkness invested in the company. Flagler negotiated reduced rail freight rates for the company due to the high volume of the company oil transported by the railroad companies. This accorded with Rockefeller's ambition to increase the company's market share and form an alliance of oil refiners. In 1870, the company was reorganized as the Standard Oil Company, a joint stock company with Rockefeller as president.

Under Rockefeller's guidance, Standard grew through acquisition, and the company participated in the ill-fated National Refiners Association to allocate crude oil between refiners, thus controlling production and pricing. The company successfully defeated attempts to challenge its market dominance and integrated vertically, acquiring assets. Standard's attempts to gain and maintain a monopoly over the U.S. oil industry fell foul of Ohio state law. To circumnavigate the statutory limitations on Ohio companies owning property in other states or

stock in non-Ohio companies, Standard Oil adopted a system whereby company officials held stock in other companies as trustees. This was the first and the largest of the "trusts." In 1879, the system was simplified so that only three people acted as trustees. Three years later, the trust was reorganized again.

Under the Standard Oil Trust agreement, a nine-member Board of Trustees held the stock of the Ohio company and its subsidiaries. These trustees gave former stockholders certificates entitling them to a certain proportion of the share dividends. After the Ohio Supreme Court annulled the charter of the Ohio company in 1892, control of the trust was transferred to the Standard Oil (New Jersey) and several other units.

In 1899, the trust was reorganized for the last time when Standard Oil (New Jersey) became the sole holding company. Rockefeller had retired from day-to-day management of the trust two years earlier, although he continued to hold the title of company president until the Supreme Court ordered the company to be broken up in May 1911. Not surprisingly, Rockefeller remained closely identified with the trust and was the focus of its public criticism. Rockefeller chose not to respond to his critics, preferring to refute their image of him through his philanthropic works.

#### SEE ALSO

antitrust; Standard Oil Company; Sherman Antitrust Act; robber barons.

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## Rockwell International

ROCKWELL INTERNATIONAL, the largest contractor working with the National Aeronautics and Space Administration (NASA), was indicted in 1991 for over-billing the U.S. government for space



shuttle repair and production work. It marked the fourth time in a decade that Rockwell was accused of mischarging the government. The company pleaded guilty in two of the earlier cases and agreed to an injunction against submitting false claims to the government in the third.

The NASA case involved allegations that Rockwell's Collins avionics operation, based in Cedar Rapids, Iowa, inflated records of the amount of time spent on NASA contracts by padding employee time cards and sending the agency false bills. The Cedar Rapids grand jury indictment charged the firm with 15 counts of conspiracy, mail, and wire fraud, and failed to specify when the alleged conspiracy took place, but suggested it started by 1979 and continued at least through August 1987. Two individuals were also indicted, one a current Collins manager and one a former Collins manager, who allegedly told employees to "soak the shuttle," "hose NASA," and "fix the numbers."

The government suspended the Collins division from obtaining further government contracts because of the unit's indictment, but the Air Force soon lifted its suspension in the belief that Rockwell took a number of actions to prevent a recurrence of the false billings. NASA continued to investigate. Rockwell then agreed in 1992 to pay \$1.4 million as part of a compliance agreement with the government to drop charges. It could have been fined as much as \$7.5 million.

#### SEE ALSO

government contract fraud; compliance programs.

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## Roosevelt, Franklin D. (1882–1945)

IN NOVEMBER 1932, Franklin Roosevelt, popularly known as FDR, won the presidential election

in the midst of the worst depression the country has ever known. Ignoring the tradition of a two-term limit on the office begun in 1799 by George Washington (1732–99), Roosevelt also won the next three elections. Roosevelt led the United States through the twin crises of the Great Depression and World War II and is ranked along with Abraham Lincoln (1809–65) as the two best presidents in American history. Lincoln was often called a "constitutional dictator" because of the extensive powers he used to deal with the Civil War. In turn, Roosevelt reshaped the office of the presidency by amassing extensive emergency executive powers that changed presidential powers and defined the modern presidency.

With the stock market and the banking industry reeling from the effects of the Depression early in the Roosevelt administration, the Department of Justice (DOJ) began intensive investigations of white-collar crimes. In 1933, Congress passed the Securities Act of 1933, which became popularly known as the Truth in Securities Act. Since the bill had been designed "to prohibit deceit, misrepresentation," and other kinds of securities fraud, DOJ was frequently involved with prosecuting violations of the act.

In 1942, after the Japanese attack on Pearl Harbor, the Roosevelt administration cited emergency powers against espionage and sabotage in rounding up and interning Japanese Americans in California. Federal lawmakers on the West Coast spent a good deal of time rounding up those who refused to comply with the restrictions on their activities. Roosevelt issued Executive Order 9066, "giving authority to certain military commanders to prescribe military areas from which any or all persons may be excluded, and with respect to which the right to enter, remain in, or leave, shall be subject to the discretion of the military commander." This order was upheld by the U.S. Supreme Court in *Korematsu v. United States*, and was not finally resolved until 1988 when the government paid reparations to surviving internees.

Roosevelt was well aware of the problems with war profiteering that had plagued Woodrow Wilson during World War I, and he forcefully announced throughout World War II that he did not want to see a single millionaire made by exploiting war production. Much of the information about war profiteering as well as abuses and waste in government contracts was derived from a Senate Committee

chaired by Senator Harry Truman (D-Missouri). Federal lawmakers were vigilant in enforcing bans against war profiteering and policing American interaction with Axis countries. Nevertheless, records released in the late 1990s revealed that a number of American businesses (IBM, for one) had been either overtly or covertly involved with Nazi Germany.

## THE NEW DEAL

Roosevelt was a pragmatist and responded to the economic and social emergency of the Depression. He believed that the government had a responsibility to do everything that was possible to turn the country around, and he was willing to do anything within his presidential power to bring this about, regardless of whether that power exceeded his Constitutional authority.

Roosevelt made the banking crisis his first priority. He called Congress into special session and declared a four-day bank holiday and established control over the export of gold. He would later remove the United States from the gold standard. Within five days of FDR's inauguration, the Emergency Banking Act had become law. An upswing in public confidence was immediate, and the stock market reopened after the banking holiday in a "bullish mood."

Roosevelt's next move was to curb federal payments by cutting the salaries of Congress members and all federal personnel and decreasing the benefits paid to veterans. FDR estimated that these cuts would slash half a billion dollars from the federal budget. In response to campaign promises, Roosevelt asked Congress to authorize a modification of the Volstead Act, legalizing the sale of beer and light wine. He had promised in the 1932 campaign to promote passage of the 21st Amendment, which repealed Prohibition, and it was ratified on December 5, 1933.

In what became known as the first Hundred Days, Roosevelt initiated a number of additional major policy reforms: The Federal Emergency Relief Act, Agricultural Adjustment Act, Emergency Farm Act, Tennessee Valley Authority (TVA) Act, Truth in Securities Act, Emergency Conservation Work Act, Home Owners' Loan Act, National Recovery Act, National Recovery Administration, Glass-Steagall Banking Act, Farm Credit Act, and Railroad Coordination Act, all quickly passed in a flurry of legislation.

After the Hundred Days, Roosevelt succeeded in implementing an enormous amount of social welfare legislation that included: social security, public housing, unemployment compensation, and public works projects. Many of FDR's policies were accomplished through executive order. For example, Roosevelt established the Fair Employment Practices Commission to prohibit discrimination in hiring among government agencies and military suppliers. FDR was also active in establishing foreign policy initiatives. He opened diplomatic relations with the Soviet Union, announced the Good Neighbor Policy toward South America, and promoted a Reciprocal Trade Agreement, lowering tariffs and extending free trade.

When Roosevelt was blocked, he reacted by bulldozing his enemies. While members of the Democratic Caucus usually supported New Deal legislation, Southern Democrats and Republicans quire often did not. In retaliation, FDR launched a campaign in the 1938 elections to convince voters to remove recalcitrant members of Congress from office and endorsed other candidates that were Roosevelt supporters. He was only partially successful.

## PACKING THE COURT

When the Supreme Court found early New Deal legislation unconstitutional, Roosevelt devised a court-packing scheme that would have added a new, liberal justice for every current justice over the age of 70 who would not retire. Despite the general outrage and the refusal of Congress to fall in line with this clear abuse of executive power, Roosevelt's scheme worked. In what became known as "the switch in time that saved nine," members of the court decided to change their position on New Deal policies, and the number of the court remained at nine.

In the wake of Pearl Harbor, Roosevelt's executive style was more welcome and Congress passed the first War Powers Act, giving FDR an incredible amount of power to oversee the fitting of the nation for war. It was up to the president to establish defense priorities, control rationing and supplies, and identify what could and what could not be produced by American manufacturing plants. If a plant refused to cooperate, the president was given the authority for the government to take it over for the war effort. By executive order, Roosevelt established the Office of Price Administration (OPA)

and the Office of Economic Stabilization, giving them extensive power over prices, wages, and profits. OPA was also in charge of rationing war goods and scarce items, such as butter, sugar, shoes, automobile tires, and gasoline. FDR also created the War Labor Board and gave them extensive powers to regulate labor and impose sanctions when necessary. In 1942, the Emergency Price Control Act retroactively endorsed FDR's emergency agencies. During the war, other agencies sprang up like wildfire, creating continued contention between the president and Congress.

In a major leap forward toward ending gender discrimination, the Roosevelt administration was much more open to employing women than previous administrations of either major party had been. Since FDR had not been supportive of women's suffrage as a young senator, much of the credit for his turnaround has been given to his wife Eleanor (1884–1962). At her urging, FDR appointed Frances Perkins (1882–1965) as the Secretary of Labor, the first American woman ever to serve in a Cabinet position. Women made great strides during World War II. Actively recruited by the government, women entered the work force in unprecedented numbers and engaged in jobs that had previously been closed to them. For example, female pilots did most of the ferrying of planes and military equipment to release men for active military work. Thousands of women also served at the frontlines as nurses or as representatives of various organizations, and at home, women worked in factories, government, businesses, and the defense industry.

Roosevelt's near-dictatorial powers, contrary to the spirit and the laws of the U.S. Constitution, extended to the world stage by the closing days of World War II. As negotiations began for planning a post-war world, the leaders of the United States, Great Britain, the Soviet Union met at the Yalta Conference from February 4 to 11, 1945, at a remote location on the Black Sea.

Carving up the postwar world not unlike any cabal of capitalists, the conference established territorial changes and postwar governments for Germany and other Axis countries. Hindsight has shown that Soviet leader Josef Stalin entered the conference determined to acquire territory for the Soviet Union that would provide opportunities for expanding communism throughout Europe. This strategy proved successful in paving the way for Poland, Czechoslovakia, Hungary, Rumania, and

Bulgaria to become Soviet satellites. Germany was divided into separate occupation zones, with the United States, Britain, the Soviet Union, and France each in charge of a section. By 1945, 13 years of steering the United States through the twin crises of the Great Depression and World War II had taken a great physical toll on Roosevelt who had developed polio in 1921. In the final days of the war, the president died on April 12, 1945.

#### SEE ALSO

World War II; Truman, Harry; reform and regulation; United States; gender discrimination; elite crime.

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## Roosevelt, Theodore (1858–1919)

AS SCION of a prominent and wealthy New York family, Theodore Roosevelt was an unlikely candidate to become a corporate reformer. Roosevelt began his reform career in 1888, serving on the National Civil Service Commission, appointed by Republican Benjamin Harrison and continuing for two more years under Grover Cleveland. Under Republican Mayor William L. Strong, Roosevelt served as president of the New York City Police Commission, where he made a name for himself as a reformer, going after the department's notorious ties to criminal elements and demanding increased professionalism. He was named assistant secretary of the navy during the first William McKinley administration, but resigned to embark on his brief-

but-exciting adventures in Cuba during the Spanish American War. Beginning training with his Rough Riders in May, he was home by August. This enhanced his public image and assured his nomination as Republican party candidate for governor of New York, provided he promised to consult the Grand Old Party (GOP) Republican machine, led by Senator Thomas C. Platt.

Roosevelt won a relatively narrow victory over his Democratic opponent. He was never a follower, and he had an independent streak that was apparent even during his tenure as governor, with his early efforts to control corporate greed and with his political appointments. New York Republicans were glad to see him move on to Washington, D.C., as vice presidential candidate for the second McKinley campaign. In a party that did not like surprises, Roosevelt's wide personal appeal trumped his reputation as a wild card. Few could foresee that he would assume the presidency, as he did in September 1901 following McKinley's assassination.

Less than six months after taking office, Roosevelt launched his first salvo against the great corporations when his attorney general announced pending action toward the Northern Securities Company. The result of an attempted takeover of the J. P. Morgan-controlled Northern Pacific by the upstart E. H. Harriman had turned into a fateful stock market corner in May 1901. As a compromise to "protect their assets," the Northern Securities Company combined the assets of the Northern Pacific, the Great Northern Railroad, and the Chicago Burlington and Quincy under the ownership of Morgan, Harriman, and James J. Hill, three of the era's most formidable financiers.

Roosevelt knew that if his action was upheld, it would overturn a 19th-century precedent that limited the ability of government regulation of interstate commerce. When Roosevelt authorized Attorney General Philander Knox to file an antitrust suit, thus signaling his intentions to test the limits of the Sherman Antitrust Act, he placed himself in direct opposition to J.P. Morgan, who, under the McKinley administration, had acted without restraint as the country's *de facto* central banker.

By the summer of 1902, Roosevelt was campaigning in the midterm elections using his bully pulpit to gain advantage in the public relations battle, stating: "The great corporations which we have grown to speak of rather loosely as trusts are the creatures of the State, and the State not only has the

right to control them, but is duty-bound to control them, wherever the need of such control is shown."

As the antitrust action made its way through the courts, Roosevelt planned to increase the pressure on railroad trusts. Roosevelt's first success was an increased appropriation for the new antitrust division of the Justice Department. Congress passed the Elkins Law outlawing rebating shortly thereafter, which was supported by the Railroads themselves against whom shippers had used rebate threats to lower rates. The rest of Roosevelt's program would prove more difficult.

To move things along, Roosevelt sought the assistance of Morgan lieutenant George Perkins. The Senate passed a bill creating the Department of Commerce and Labor in January 1903. Only the House version, passed on January 17, 1903, allowed for a Bureau of Corporations that would specifically investigate corporations and report to the president, giving Roosevelt a certain amount of executive discretion.

## OREGON LAND SCANDALS

While Roosevelt's conservation efforts are well known, the Oregon Land scandals, which partially precipitated action to transfer authority over land from the general land office to a new Bureau of Forestry, are often overlooked. Commissioner of Public Lands Binger Hermann, working with public officials including Senator John H. Mitchell, had assisted the fraudulent transfer of public lands to large mining and lumber companies in the Pacific Northwest. Roosevelt appointed a new commissioner, William A. Richards, former governor of Wyoming, and while visiting Oregon in May 1903, ordered Richards to investigate. The dimensions of the scandal grew over next several years.

This mishap set the stage for Roosevelt's creation of a Public Lands Commission, to which he appointed Gifford Pinchot, Richards, and Frederick H. Newall. The commission was directed to report on the condition and operation of existing land laws and to recommend public land policy.

These efforts did not end the Roosevelt administration's reliance on major lumber and cattle corporations in developing public land policy, which favored sustained yield and grazing leases over preservation as advocated by John Muir and others, and excluded small-scale stockmen and lumber operators.

A Post Office Department scandal became public in spring 1903, leading to the resignation of the superintendent in charge of salaries, followed by an assistant attorney general charged with destroying documents. Charles Emory Smith, postmaster general under McKinley, and his assistant Perry S. Heath faced accusations of using political corruption, but lack of evidence prevented prosecution.

Roosevelt won the 1904 election on the basis of his immense popularity. However, the Democrats raised the issue of contributions from the very corporations that Roosevelt had been trying to regulate. This issue would continue to brew during Roosevelt's second term, as the public began to perceive the tremendous political power of the new corporations. Popular publications including *McClures Magazine*, *World's Work*, and *Colliers* focused public attention on corruption in cities, unsafe products, diseased food, and unscrupulous business practices.

As a result, the public was ready to back Roosevelt's progressive program of business regulation. A major target continued to be the railroads. While previous legislation had outlawed rebates, there remained a perception that rates unfairly discriminated against certain localities and even regions, particularly the South and Midwest. The Pure Food and Drug Act and regulation of the meat industry followed. Legislation had been proposed since the mid-1890s, but stalled through 1903 due to pressure from the food industry. Muckrakers' efforts to expose patent drugs coupled with the work of the new Consumers League and American Medical Association resulted in a Pure Food and Drug bill that was introduced by Senator Heyburn of Idaho in December, 1905.

Nearly simultaneously, publication of Upton Sinclair's *The Jungle* sparked investigation of Chicago, Illinois, stockyards, which were dangerously unclean and unsafe. A meat inspection law was introduced May 1906 and was signed into law on June 30 along with the Pure Food and Drug Act. Senator Albert J. Beveridge pronounced it "the most pronounced extension of federal power in every direction ever enacted, including even the rate bill itself."

In 1906, Garfield had begun an inquiry into monopolistic practices of Standard Oil, which threatened independent oilmen in Kansas, and concluded that Standard Oil had been receiving secret rebates and other illegal discriminations. This culminated

in a move by Department of Justice to dissolve Standard Oil of New Jersey in November 1906. The department also investigated and threatened action against International Harvester, an American Tobacco Company accused of ruthless tactics toward independent wholesalers and retailers. The Department of Justice sued American Tobacco in July 1907, as the White house urged abandonment of the planned suit against International Harvester, another Morgan holding. By now the Roosevelt administration doubted that the Sherman Antitrust Act could truly be enforced.

Roosevelt preferred a middle way of fighting monopoly while respecting the economic and social contributions of big corporations. At Roosevelt's direction, James R. Garfield of the new Bureau of Corporations conducted investigations and then "reached understandings" with the corporate leaders. Sometimes these agreements prevented legitimate prosecution by the Department of Justice. In the case of the beef industry, Garfield actually promised immunity to companies, eventually thwarting their prosecution by the Justice Department.

#### SEE ALSO

Justice, Department of; antitrust; Sherman Antitrust Act; Sinclair, Upton; Food and Drug Administration; tobacco industry; monopoly.

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## Ross, Edward (1866–1951)

E. A. ROSS was a very influential sociologist of his time. He was well known as one of the founding fathers of American sociology. Ross attended Coe College in Iowa where he earned a A.B. degree in 1886. Awarded his Ph.D. from Johns Hopkins University in 1891, his career spanned over 35 years and his influence is still felt today. The basic elements of Ross's extensive work can best be exam-

ined in his *Foundations of Sociology* (1905), *Social Control* (1901), *Social Psychology* (1908), *Principles of Sociology* (1920, 1930, 1938), and *Sin and Society: An Analysis of Latter-Day Inequity* (1907). Ross explored the subject matter of sociology and the nature of sociology in relation to the other social sciences.

Although he never conducted research on crime or developed specific criminological theories, his research on social control has had a major impact on criminology. In fact, he provided the first separate dialogue on the subject. Ross outlined the theory of social control by identifying the grounds of control, the means of control, and the system of control.

His book, *Sin and Society*, vividly expressed his dismay about corrupt business practices. Ross conceptualized the idea of the criminaloid as a social type who enjoys a public image as a pillar of the community and a paragon of virtue; but beneath this veneer of respectability is actually a very different persona, one that is committed to personal gain through any means. The criminaloids encounter feeble opposition and since their practices are often more lucrative than the typical criminal act, they distance their more scrupulous rivals in business and politics and reap an uncommon worldly prosperity. The key to the criminaloid is not evil impulse, but moral insensibility.

The criminaloid prefers to prey on the anonymous public and is therefore an even greater threat. He even goes beyond this by convincing others to act instead of acting himself, which protects him from liability and being labeled a criminal, and is instead immune to such scrutiny. The criminaloid practices a protective impersonation of the good. The criminaloid counterfeits the good citizen.

The criminaloid plays the support of his local or special group against the larger society. He identifies with some legitimate group and, when necessary, he calls upon this group to protect its own. He will use guile and political connections to rebuke reforms which would have an impact on his practices. Ross believed so long as the public conscious is lazy, the criminaloid has no sense of immorality. The criminaloid flourishes until the growth of morality overtakes the growth of opportunities to prey upon.

Ross regarded these criminaloids as men who lacked morals and he believed that they were directly accountable for unnecessary deaths of consumers and workers. Ross believed that these actions needed to be examined and they were just

as, if not more, harmful than the ordinary criminal. The criminaloid personifies the corporate criminal and is an antecedent of Edwin H. Sutherland's white-collar criminal.

#### SEE ALSO

Sutherland, Edwin H.; differential association theory; self-control theory.

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## Rostenkowski, Daniel (1928–)

AN ILLINOIS Democrat, Dan Rostenkowski served 18 terms in the U.S. House of Representatives between 1958 and 1994. He used the Congressional seniority system to eventually assume the chairmanship of the House Ways and Means Committee which controls the government's purse strings. In that role, Rostenkowski became one of the most powerful figures in Washington, D.C. He also used his influential position to plunder the government on behalf of himself, his family, and his friends.

### 17 COUNTS OF GREED RUN AMOK

Rostenkowski's bid for a 19th term ended in defeat in 1994 at the hands of a political unknown after he had been indicted earlier that year on 17 felony counts of corruption. The indictment painted a devastating picture of greed run amok. The charges included placing "ghost" employees, who did little or no work, on the Congressional payroll, using

government employees to remodel his home at taxpayers' expense, charging expensive gifts for friends to his Congressional account and falsely representing them as official items, illegally billing the government for fraudulent car leases, converting campaign money to personal use, and obstructing justice by asking grand jury witnesses to withhold evidence. The most flagrant of the allegations, and the one that spoke volumes of his petty larceny, involved Rostenkowski's routine practice of exchanging stamps from the Congressional Post Office for cash. Added together, the cost of Rostenkowski's embezzlement and misappropriations was nearly \$700,000.

On April 9, 1996, Rostenkowski entered into a plea bargain in federal court under which he agreed to plead guilty to two counts of mail fraud in exchange for the government dropping the remaining counts. He was sentenced to 17 months in prison and fined \$100,000. He was paroled in 1998 after serving 13 months in a federal penitentiary. When she imposed his sentence, the presiding judge declared Rostenkowski's misconduct a "reprehensible breach of trust."

Rostenkowski later worked as a political consultant and commentator. He received a presidential pardon in 2000 during the waning hours of the Bill Clinton administration.

#### SEE ALSO

corruption; mail fraud; wire fraud.

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## Rusnak, John (1964–)

A FORMER TRADER for Allfirst Bank (a U.S. mid-Atlantic regional bank known in 2004 as M&T Bank), John Rusnak pleaded guilty to bank fraud on October 24, 2002, in connection with the \$691.2

million the bank lost through his foreign-currency trading.

Rusnak, hired by Allfirst as a trader in 1993, suffered trading losses buying yen for the bank in 1997. He then began to hide some losses, and the size of reported losses by using fictitious options and changing the currency exchange rates which came into the bank's trading system. False trades disguised the fact that Rusnak was also trading over his limit and taking risks that were too high. The 2002 Ludwig Report on the incident found that Rusnak broke rules that should have offered safeguards, and that he manipulated personnel who should have been supervising and checking on his activities.

Among other points, the report also determined that the bank's internal auditing was deficient and Rusnak's supervisors were not sufficiently experienced or competent to supervise him. Trading was done with Allfirst's funds rather than that of bank customers so it was Allfirst itself that took the losses. Rusnak earned performance bonuses of more than \$650,000 beyond his salary due to the appearance of profitable trading.

In January 2003, Rusnak was sentenced as part of a plea agreement to 90 months (7.5 years) in prison and ordered to pay restitution to the bank or its successor. The judge also ordered that during the five years he was on probation following the incarceration, Rusnak enter substance abuse and gambling programs, and pay \$1,000 per month restitution. Unless the federal government gave permission, Rusnak was also forbidden to ever work at a bank. Also dismissed by Allfirst were co-workers, supervisors, and managers who did not notice the fraud and losses.

#### SEE ALSO

bank fraud; securities fraud; Allied Irish Banks; Securities and Exchange Commission.

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## Russia

WHITE-COLLAR, corporate, and organized crime in Russia literally exploded in the years following the disintegration of the Soviet state in the late 1980s and early 1990s. By 2003, the statistics were staggering: In addition to controlling conventional illegal practices such as drug trafficking, prostitution, and money laundering, it is estimated that the Russian Mafia controls as many as half the banks in the country as well as key economic sectors such as petroleum distribution, pharmaceuticals, and consumer products distribution.

Their influence reaches into the highest levels of government and industry. It is widely acknowledged that the Mafia has close links with ranking members of the Russian government. The arrest and forced exile of leading business figures such as Boris Berezovsky, Vladimir Gusinsky and, most notably, the arrest in 2003 of Mikhail Khodorkovsky, Russia's richest man and the dominant figure in Russia's petroleum industry, signals less a crack-down on organized crime than a power play between rival power factions at the top of society. The dominance of organized crime in Russia reflects the deep crisis in the Russian economy.

Some commentators see the rise of organized crime as part of a semi-feudal system inherited from Soviet totalitarianism. Others contend that it is somehow rooted in the Russian character itself, flowing from the "backwardness" and "underdevelopment" of primitive "Eastern" economies. While these interpretations go some way in capturing the shocking extent of corruption, violence, and inequality linked to organized crime, they resolutely miss the mark in understanding the origins and development of the Russian Mafia. It is necessary to firmly place organized crime within the context of late-20th century capitalism as a whole, as well as within the specific trajectory of the Russian economy and society from the Soviet regime to the 21st century. As Boris Kagarlitsky persuasively argues, "In the 1990s, post-communist capitalism was not being 'civilized,' but Western capitalism was turning savage. It was simply that the scale and consequences of the reforms on the periphery were far more striking than in the center."

The crisis is certainly rooted in the nature of the Soviet system. Yet the rise of the Mafia should also be situated in the shock therapy program of privatizations, structural adjustment programs, and

gutting of social welfare urged on by Western politicians and corporations. Indeed, Vadim Volkov argues convincingly that organized crime "rests on the division between the legitimate world and the underworld." To understand organized crime in the former Soviet Union, thus requires looking at the connection between and overlapping of both traditional areas of criminal activity and so-called legitimate economic activities.

### ORIGINS OF CRIME

Severe economic problems existed in Russia long before the reform programs of Soviet Premier Mikhail Gorbachev brought them to world attention in the mid-1980s. What Mike Haynes calls the "centrally directed, military industrialization" program of the command economy and the competitive pressures of the world market led to a top-heavy and inefficient economy from the 1960s onward: "Too often, from a global point of view, Russia had the wrong type of industry in the wrong place; plants were too large, turning out too diversified a range of products with equipment that was less efficient than that elsewhere in the world economy." Consequently, parallel economic structures mushroomed, creating power centers that gradually became independent of the state. As the bureaucratic machine disintegrated, a barter market proliferated which further weakened the system of centralized production and supply of goods.

In the wake of the crumbling of the state-controlled economy, Russian governments in the 1990s based their economic policies on three key planks: privatization, liberalization, and macro-economic stabilization. Abolishing price controls led to rapid inflation and a monetary crisis. Newly privatized companies were short of cash and forced to expand the existing barter economy to secure financing and supplies. Productivity and productive output fell precipitously: both industrial and agricultural production declined by almost half from 1989 to 1995. Few companies paid their taxes which led to a crisis in state finances, savage cuts to social services and massive layoffs or failure to pay wages in the public sector. The "shadow" economy of smuggling and black markets grew to represent some 40 percent of the gross domestic product.

The effects of economic crisis have been devastating on the Russian population. The United Nations' UNICEF agency laments the "demographic



implosion,” “appalling numbers of excess deaths” and spiraling suicide rate among young people. Real wages have fallen by 40 percent. A majority of the population lives below the basic poverty line. Life expectancy for Russian males in the late 1990s was lower than in India.

It was the Russian Mafia and its political allies in the state and legitimate business that stepped in to fill the vacuum resulting from economic chaos. It is worthwhile first underscoring the links between the old Soviet ruling class and the new political and economic elite. Many current politicians, business leaders, and Mafia figures cut their teeth in the ministries and economic agencies of the Soviet state. As Mike Haynes states, “There is an irresistible body of evidence to indicate that the people now in charge in Russia are substantially the same as those who ran it in Soviet times.” Citing Russian academic Olga Kryshтанovskaya, he observes that former Soviet officials accounted for 74.3 percent of the government and 75 percent of President Boris Yeltsin’s presidential team in 1995, including Yeltsin himself. The figure reaches as high as 82.3 percent among the regional state chiefs. Among the new business elite, the figure is 61 percent, but Kryshтанovskaya admits that this is probably an underestimate since many of the current business oligarchs and their deputies were unofficial agents of state bosses in the Soviet regime.

In the old Soviet system, black marketing, bribery, and corruption of officials had become widespread by the 1970s and expanded through the early 1990s. Controlled by a tightly knit corps of leaders nicknamed “sharks,” they had, according to Aleksandr Gurov, “diversified criminal organizations with quite extensive regional connections ... They included representatives of the administration of various [state] enterprises who often were [Communist] party members and had high positions.” Many of the organizations began first with illegal protection rackets and smuggling. When the Soviet state collapsed, these small-scale criminal outfits, along with a range of other semi-legal and legitimate business people, many of them former state officials, were best placed to take advantage of the economic chaos that resulted from neo-liberal economic policies.

The process of privatization of state industries in the 1990s provided the most lucrative access for organized criminal elements, allowing them to consolidate and expand their traditional illegitimate

business interests as well as venture into “legitimate” endeavors. The process went as follows: A state company would be abolished and replaced by a joint-stock company with the same personnel and assets as before. The controlling shares would pass into the hands of the state and be sold at deflated prices to a new cadre of leaders largely comprised of existing officials tied to Mafia interests. Windfall profits would be gained from these fire sales.

This process occurred in the huge raw material and natural resource industries as well as banks; in some cases, deals have then been made with Western companies as in the case of the mega-merger of British Petroleum and the Tyumen Oil Company of Siberia. The latter company has been suspected of numerous legal violations since it was formed in 1997 out of the privatization of a Soviet-era state company. The billions of dollars in profits made by these turnovers and by the export of goods produced in these industries have, moreover, been spirited away into Western bank accounts, garnering huge fortunes for a small minority of business tycoons. As much as 65 percent of Western aid in the 1990s was also stolen by such elites and ended up in private bank accounts in Switzerland and elsewhere.

## ELITE CRIME

This new business elite, considered legal and democratic, but with close ties to organized crime organizations, has, according to James Hughes, “succeeded in dramatically eclipsing other social groups” in local, regional and national politics. Leading criminals have even been elected as deputies in the Russian Duma (legislature) where they use their influence to dole out tax breaks and other benefits to friends and allies.

A similar process of corruption by organized crime in concert with local politicians has occurred among those private companies that sprung up in the 1990s to pick up the slack of the declining state companies. Organized crime and/or local political leaders would force companies into bankruptcy by cutting off credit or disrupting production and sales. They would then coerce managers and buy the company at rock-bottom prices, relying on the promise of contracts with cozy regional governments to gain large profits. Other types of economic crime include transfer pricing, the act of insider or parent holding companies purchasing goods at below market prices and then reselling

them at higher prices. Yet another consists of buying raw materials and natural resources at domestic prices and then illegally reselling them in the higher-priced international market. In these ways, by early 1997, 41,000 companies, 400 banks and 80 percent of all joint ventures were controlled by organized crime.

### CASE IN POINT

The banking industry is an interesting case in point. Large banks and the state are interdependent. The state, as emitter of bonds and as the regulating agency of the monetary system, is an important customer of the banks. The state, in turn, relies on banks to finance the deficit and stabilize financial markets. In this environment, extensive networks of corruption have developed. The banks gain preferential treatment from the state through sales of bonds at low prices and return the favor by financing political campaigns.

Banks have also been given control of managing state funds and the privatization process. With the control of the auctions of state industry, the banks ended up buying many privatized companies for negligible prices and have in this manner developed into powerful financial-industrial groups. Banks not yet powerful enough to gain favors from the state focus on the profits to be gained from investment fraud, forgery, money laundering, and transfer of capital to the West.

Capital flight, estimated at \$100 billion since the early 1990s, meant fewer taxes for state coffers (only 15 percent of companies paid their taxes in full and on time in 1998) and a drain on hard currency which is used to pay off the spiraling state debts to Western banks. The state itself was thus weakened through this process of privatization and liberalization. In addition to the effective loss of power in economic planning, tax and monetary policy, even the security forces themselves (military and police) lost the capacity to investigate and prosecute organized crime. Private security forces hired to protect enterprise and composed of ex-members of the Soviet military and secret police blossomed under the auspices of organized crime. Intimidation of competitors and the few state security agencies that remain have led to violence, including beatings, arson, and assassinations.

The state defense industry that sells military hardware, including nuclear technology, to foreign

governments has been pilfered of billions since the early 1990s. In 2002 alone, \$5 billion in profits were made through the sales of arms yet only a tiny fraction ended up in government accounts since well-placed government officials, tied to organized crime, intervened to skim off the majority of profits. Huge brokerage and freight fees are paid to foreign intermediaries or dummy companies and production costs are exaggerated so that most of the profits end up in the hands of a few insiders.

The money is then laundered in foreign countries, such as Cyprus, and divided up among the players. While the state is the nominal producer of these defense products, it ends up with almost nothing. The assassinations of two leading directors of state defense industries in June 2003 signaled that the ferocious competition among criminal organizations to muscle in on arms sales has moved to a violent stage.

In addition to infiltration and dominance of legitimate business, organized crime has considerably expanded its traditional criminal activities, using connections and profits from one to finance and support the other. Activities run the gamut from drug trafficking and prostitution to money laundering and credit-card fraud. Many of these activities have expanded to include extensive operations in other Eastern European countries, North America, Europe, Israel, and South America. The extent of the power of organized crime outside Russia's borders is shown by the well-documented takeover of legitimate business in Russian emigré communities in the West.

### HUMAN TRAFFICKING

Perhaps one of the most worrying developments is the growth in trafficking of women for the purpose of sexual exploitation. Under the control of organized crime in Russia, it has expanded in recent years into a multi-billion dollar market. Estimates suggest that as many as 500,000 women, largely from Russia, the Ukraine, Belarus and Latvia have been literally sold into prostitution to countries around the world. Mafia organizations falsely advertise in newspapers offering lucrative job opportunities abroad for women and then kidnap them and force them into prostitution. Other methods include recruitment to mail-order bride schemes, or entertainment tours where women have legal visas and are supposedly part of touring entertainment com-

panies. Researchers stress that this form of modern-day slavery exists because of demand from the receiving countries which include many European, North American, and Asian nations.

There are few signs that organized crime will be broken or even reduced in the coming decade. The extent of the economic crisis in the former Soviet Union is so deep that criminal elements have infiltrated the highest echelons of economic and political power. Western nations, too, have largely turned a blind eye to such activities as they rely on the diplomatic support of the Russian government, and are firm supporters of the shock-therapy programs that have aided the consolidation of organized crime. Most observers admit that the only chance for reform will come from the mass of the population itself through the creation of a reliable legal and tax system, effective law enforcement, and socioeconomic policies which reduce the massive disparity between rich and poor. Yet the type of social and political movements required to turn the tide of corruption, violence and crime have only recently begun to organize.

#### SEE ALSO

public corruption; corruption; organized crime; prostitution; human trafficking.

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# S

## Salomon Smith Barney

DESPITE ITS REPUTATION as an investment company that has produced solid results for its clients, Salomon Smith Barney (SSB) became mired in the corruption and greed that shook the securities industry in the 1990s. Smith Barney, which was founded in the late 19th century when the firms of Edward B. Smith and Charles Barney combined, was bought by Travelers Group in 1992. Travelers united Smith Barney with Salomon, Inc. Scandal hit the company in 1991 when Salomon's Paul Mozer set up a scam in which he used unsuspecting clients to buy more two-year Treasury notes than the legal limit allowed by the federal government. Of the \$12.26 billion sold at a Treasury auction on May 22, 1991, Salomon bought 90 percent. As a result, the company was forced to pay a \$290 million fine for defrauding the U.S. Treasury.

While Salomon Smith Barney was still recovering from the Treasury fiasco, government regulators levied a \$300 million fine when it was discovered that SSB's telecom research analyst, Jack Grubman, had falsified company reports to make certain companies appear healthier than they actually were, causing a number of investors to lose substantial amounts of money. Federal and state regulators had little trouble tracing the actions in which Grubman promoted a number of companies that later went

bankrupt, because he left a substantial e-mail trail. Investigators also uncovered information that led them to believe that the company's rivals had been paid to issue misleading reports to make designated companies look inviting to investors. Although he never admitted any wrongdoing, Grubman was ultimately banned from the securities industry for life and was forced to pay a \$15 million fine.

Sandy Weill, chairman of Salomon Smith Barney, who was once known as the most powerful person on Wall Street, also fell victim to the scandal. Investigators learned that Weill had made a \$1 million donation to an exclusive nursery school to ease the way for the application of Grubman's child. Weill has since been allowed to speak to SSB analysts only in the presence of lawyers.

He was also taken to task for not properly supervising Grubman and other individuals who provided misleading financial analysis, and he was required to issue a public apology to SSB clients. Evidence revealed that other SSB executives had also turned a blind eye to tainted research. For example, Michael Carpenter, who headed up SSB's global equity research team, was warned in a December 2000 memo that "legitimate concerns" had been raised "about the objectivity of [SSB] analysts."

While SSB was only one of 10 investment companies caught up in securities scandals in the 1990s,

the company received the stiffest fine and was severely taken to task by federal and state regulators

As if financial scandals were not enough, the Los Angeles, California, office of SSB also became caught up in a sexual discrimination case in 1997. Around 2,000 female employees accused the company of creating a sexually hostile working environment. In December 2002, the women were awarded \$3.2 million in compensatory and punitive damages after it was revealed in court that male employees had engaged in intimidation, ridicule, and insults in addition to playing pornographic videos, and engaging in other sexual activities.

One-fourth of the money from the securities fines was allotted to states, and the rest was distributed among various investors who were able to document that their losses derived from tainted research given them by Salomon Smith Barney. Investigators have also been interested in SSB's ties to the Enron Corporation scandal. Perhaps to distance itself from its scandalous past, Salomon Smith Barney became officially known in 2003 as Citigroup Global Markets.

#### SEE ALSO

securities fraud; Securities and Exchange Commission; Enron Corporation.

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## Saudi Arabia

THE KINGDOM of Saudi Arabia (KSA) was created in 1932 from a region that had historically been the home of the spiritual and temporal rulers of Arabia and many of the holiest places in Islam. The traditional form of rule in KSA has been autocracy,

with the appointed leader taking counsel from a variable group of elders and advisers, many of whom are drawn from the leader's family. Decisions and policies have been left deliberately opaque. This method extends not just to the government service but also to the private sector, in which many decisions are made on the basis of mutual connections or of family trust and, hence, not subject to wider scrutiny. This has led to many opportunities for corruption and white-collar crime.

#### ABOVE SUSPICION

In common with other parts of the Middle East, many members of the ruling family consider themselves and the positions they occupy in society to be above suspicion. Each of the approximately 5,000 princes, for example, receives a royal pension and expects various privileges.

The unwillingness of the elite to be held accountable for business decisions means that bankruptcies and other failures are rarely disclosed, and so creditors and foreign workers are frequently left without compensation in such cases. This is exacerbated by the refusal of the KSA government to permit dealings with any business that also has dealings with Israel. This policy contravenes international trade law, which requires impartiality of treatment and, consequently, the KSA has not been bound to international conventions. Opposition to organized labor in the country has further meant that international labor standards cannot be enforced or even effectively monitored by the International Labor Organization (ILO). There are many reports of the abuse of domestic migrant workers and other service sector workers.

The KSA has operated under a strong policy of religious leadership in the Muslim world and this has manifested itself in the funding of various religious organizations. This funding is related to the Muslim practice of charitable giving, yet it supports the extreme form of Islamic thought, Wahhabism, which has led to tensions with Western countries. The West is considered by Wahhabite thinkers to maintain decadent and corrupt societies. Indeed, many people believe that it is their duty to combat such decadence and that they should be supported by their country and its institutions.

With the current monarch, King Fahd, and his family identified strongly with the West, particularly because of the decision to permit the station-

ing of U.S. troops in the KSA as part of the 1991 Gulf War against Iraq, extremist Islamic movements have gained strength and support. This has been manifested in terrorist attacks against Western interests by religious groups, some of which may have been supported through charitable giving. The alarming decline of the Saudi economy and the difficulties faced by educated Saudis in finding jobs they believe suitable has intensified tensions. Calls for reform of the corruption practiced by the elite have become more noticeable, and the state is reluctant to act too openly against religious dissent for fear of sparking a major uprising.

The KSA was the home of Osama bin Laden and many of the hijackers who committed the 2001 terrorist attacks on the United States. Bin Laden was a very wealthy industrialist who seems to have been able to sponsor acts of terrorism internationally from his own resources. The complexity of modern finance operations, conducted through the internet, has demonstrated the difficulties involved in tackling such terrorist money laundering.

The lack of transparency with respect to charitable giving and the anti-Western sentiment aroused by many of the religious recipients of Saudi state support have brought the kingdom under much greater scrutiny. International pressure on the Saudis to reform corporate and other practices in the early 2000s were compromised by the presence of so many of U.S. President George W. Bush's closest advisers who benefited from association with the Saudi oil industry.

Many investment deals in the oil industry require associated offset agreements by which the investing company makes additional contracts with local companies, many of which are controlled by members of the ruling elite. Some deals in industries such as armaments and aerospace are shrouded in additional layers of secrecy due to the need for security. However, it is allegedly apparent that local agents have been employed by the British government in the KSA, and elsewhere in the region, with a mandate to use bribery to obtain arms sales. One arms deal, the al Yamamah arms accord has resulted in a number of companies opening facilities in the KSA through offset arrangements, including Rolls Royce, Glaxo Wellcome and Tate & Lyle.

This Western interest has contributed to the large community of migrant Western workers in the kingdom, largely based in compounds, who were the victims of violence in 2003. Western com-

pounds have been linked with large-scale illegal alcohol drinking operations and a number of people have been arrested and imprisoned as a result of such allegations.

A number of large arms sales have also come under scrutiny as a result of suspicion that illegal commissions have been paid. The leadership and control which the kingdom exerts over the region means that the American-led reconstruction of Iraq and Afghanistan includes significant inputs from Saudi organizations, corporations, and individuals.

#### SEE ALSO

elite crime; multinational corporations; bribery; corruption; Arab nations.

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## savings and loan fraud

SAVINGS and loan fraud refers to false representations or failure to disclose significant information with the intent of denying the savings and loan association of assets that legally belong to the savings and loan association. Perpetrators of savings and loan fraud are employees, owners, or persons closely affiliated with a savings and loan, who are in a position of trust and violate that trust for the purpose of enriching themselves at the expense of the owners and depositors of the savings and loan.

A savings and loan is a type of financial institution that takes deposits and, as originally conceived in the 1930s, uses the deposits for making mortgage loans to consumers. Examples of savings and loan fraud include trading stock on inside information,

usurping opportunities or profits, engaging in self-dealing, or otherwise using the institution for personal gain.

Specific examples of insider abuse include loans to insiders in excess of that allowed by regulation; high risk speculative ventures; payment of exorbitant dividends at times when the institution is at or near insolvency; payment from institution funds for personal vacations, automobiles, clothing, and art; payment of unwarranted commissions and fees to companies owned by a shareholder; payment of "consulting fees" to insiders or their companies; use of insiders' companies for association business; and putting friends and relatives on the payroll of the savings and loan associations.

The varieties and possible permutations of criminal activity perpetrated by thrift operators are seemingly endless. By and large, however, fraud in the savings and loan industry fell into three general categories, classified as unlawful risk taking, looting, and covering up.

#### UNLAWFUL RISK TAKING

Deregulation made it legal for thrifts to invest in nontraditional, higher-risk activities, but regulations and laws were often broken in the process, either by extending these investment activities beyond permissible levels or by compounding the level of risk by, for example, inadequate marketability studies or poor supervision of loan disbursements.

The deregulation of savings and loans' investment powers unleashed an escalating competitive process in which brokered deposits were a key ingredient. Overnight, ailing savings and loans could obtain huge amounts of cash to stave off their impending insolvency. As brokerage firms shopped across the country for the best return on their money, thrifts had to offer ever-higher interest rates to attract them. In this environment, the weakest thrifts grew the fastest.

By 1984, Edwin Gray, chairman of the Federal Home Loan Bank Board (FHLBB), became alarmed over the rate of growth of brokered deposits that he had attempted unsuccessfully to re-regulate. Broker deposits often entail huge sums, at high rates for the short term—not infrequently passing through an institution in 24 hours, then moving on to the next highest bidder. Institutions whose survival depends on such jumbo deposits are clearly vulnerable to the

effects of unexpected withdrawals. Large cash infusions facilitate risky speculative ventures, but conversely and more importantly, long-shot investments with the potential for high payoffs are undertaken by institutions desperate to offset the costs of high-interest deposits.

Among the most popular of high-risk strategies used in conjunction with brokered deposits are acquisition, development and construction loans (ADC). The power of federally chartered savings and loans to invest in commercial real-estate projects was expanded with the deregulation of 1982, so that thrifts could invest up to 40 percent of their total assets in such ventures. Increasingly, high-risk loans were made to developers to acquire and develop projects for commercial use, more than tripling such loans between 1980 and 1986. As long as a high-risk ADC loan remained within the 40 percent limit stipulated by federal regulations, they did not, by themselves, constitute misconduct. The problem was that, given the competitive pressure exerted on thrifts by the new deregulation and the proliferation of high-interest brokered deposits, some thrifts exceeded the federal ceiling on ADC loans and/or committed misconduct in handling them.

#### NO-RISK INVESTING

Because these high-risk loans have potential (although are unlikely) to be very profitable in the long run, and because they provide a desperately needed cash flow in the short run (in the form of percentage points paid up front), they are an extremely attractive source of investment to which faltering savings and loans increasingly turned in the early and mid-1980s. But it was the "no-risk" federally insured nature of these high risk investments that ensured their proliferation and abuse. For, should developers default on these loans, they suffered no personal liability; and deposits were protected by the Federal Savings and Loan Insurance Corporation (FSLIC) insurance. The short-term and long-term potential of these ADC loans, in combination with their low risk for the investor, triggered a scramble among savings and loans to enter the world of speculative development (particularly in Texas and other states where no ceiling existed for ADC lending).

Deregulation started an ever-escalating competition for deposits, and pressed some thrift operators



*Detection of savings and loan fraud comes from uncovering the layers of deception like multiple amounting books.*

into high-risk, often unlawful, loan arrangements. As deregulation lifted the ceiling on interest rates and intensified competition, it provided a primary incentive for fraud, and by opening up investment powers, it provided the opportunity; by simultaneously deviating from the free market model upon which these moves were ostensibly based, and increasing the level of protective FSLIC insurance, would-be “deregulators” added the irresistible force of temptation.

## LOOTING

Collective embezzlement, also called looting, refers to the siphoning-off of funds from a savings and loan institution for personal gain, at the expense of the institution itself and with the implicit or explicit sanction of its management. This robbing one’s own bank is estimated to be the single most costly category of crime in the thrift industry, having precipitated a significant number of thrift insolvencies to date. In some cases, thrift embezzlement takes the form of buying sprees, in which thrift operators, and others with inside access to thrift funds, purchase luxury goods and services and charge them to the institution. For example, when Erwin Hansen took over Centennial Savings and

Loan in California at the end of 1980, he threw a Centennial-funded, \$148,000 Christmas party for 500 friends and invited guests that included a 10-course sit-down dinner, roving minstrels, court jesters, and pantomimes. Hansen and his companion Beverly Haines, a senior officer at Centennial, traveled extensively around the world in the thrift’s private airplanes, purchased antique furniture at the thrift’s expense, and “renovated” an old house in the California countryside at a cost of over \$1 million, equipping it with a gourmet chef at an annual cost of \$48,000. A fleet of luxury cars was put at the disposal of Centennial personnel, and the thrift’s offices were adorned with art from around the world. Hansen died before he could be formally charged, but Haines was eventually convicted of having embezzled \$2.8 million. Centennial’s inevitable insolvency cost the FSLIC an estimated \$160 million.

Other, more subtle forms of collective embezzlement include a variety of schemes to obtain excessive compensation for the institution’s directors and officers. Compensations include salaries as well as bonuses, dividend payments, and perquisites for



*Personal expenses beyond the norm for savings and loan executives now come under intense scrutiny.*



executives. The most widespread techniques of looting discovered involve an array of special deals. For example, in "nominee loan" schemes, a "straw borrower" outside of the thrift obtains a loan for a third person, who is usually affiliated with the thrift from which the loan is received. Such nominee loans are a popular device for disguising violations of the regulation which limits unsecured commercial loans to affiliated persons to \$100,000.

A related system for violating the loans-to-affiliated-persons regulation is reciprocal loan arrangements. Reciprocal loans are loans in which insiders from one bank authorizes loans to the insiders of another bank in return for similar loans. This scam has resulted in losses to taxpayers of \$26 million when the loans defaulted and the institutions failed.

So called land flips use real estate deals as the mechanism for looting. Land flips are defined as transfers of land between related parties to fraudulently inflate the value of the land. The land is used as collateral for loans based on the inflated or fraudulent valuation. Loan amounts typically greatly exceed the actual value of the land. Loan broker J. William Oldenburg bought a piece of property in Richmond, California, in 1979 for \$874,000. Two years later, after a number of flips, he had the land appraised at \$83.5 million. After buying State Savings and Loans in Salt Lake City for \$10.5 million, he sold the property to the newly acquired thrift for \$416 million in outstanding deposits.

Linked financing, or daisy chains as it is known in the industry, is perhaps the most subtle and complex of the special deals used for embezzling. Linked financing is the practice of depositing money into a financial institution with the understanding that the financial institution will make a loan conditioned upon receipt of the deposits. It often involves large brokered deposits, made by a business. The brokers can then default on their loans, essentially obtaining free cash (these are called drag loans, because the borrower simply drags away the loan, with no intention of repayment); middlemen obtain a generous finder's fee; and thrift operators record hefty deposits and inflated assets, which spell extra bonuses and dividends for thrift executives.

Looting is not confined to inside operators of thrifts. More often than not, the scheme requires intricate partnerships with those outside the industry, usually in real estate or loan brokerage. In some cases the outsiders initiate the fraud by identifying

weak thrifts as easy targets that are ripe for plucking. In one infamous deal, loan broker Charles J. Bazarian, Jr., engaged in fraudulent real estate transactions that contributed to the insolvency of two large California thrifts, Consolidated Savings Bank of Irvine and American Diversified Savings Bank of Costa Mesa. According to charges brought against Bazarian, in one instance he borrowed more than \$9.5 million from Consolidated, putting close to \$5 million of it in a partnership in which the owner of the thrift, Robert Ferrante, had a direct interest. The same year, Bazarian arranged a reciprocal transaction with American Diversified in which the thrift bought \$15 million of worthless investor notes from Bazarian's brokerage firm, in exchange for Bazarian's purchase of \$3.85 million in promissory notes and two pieces of real estate from the thrift. When federal regulator's finally closed the two thrifts, together they registered close to \$200 million in losses.

Daisy chains, dead cows for dead horses, land flips, cash for trash, cash for dirt, kissing the paper, white knights—this playful jargon reflects the make-believe, candy-store mentality of this breed of white-collar criminal and belies the devastating consequences of their actions.

## COVER UP

The most widespread criminal activity of thrift operators is the manipulation of accounting books and records, as well as engaging in transactions to cover up, or hide, from the regulator the fact that the thrift lacked sufficient capital required by statute and regulation. The thrift knows the regulator will close the thrift and the illegal activities will be brought to light.

In the cases of Manning Savings and Loan, American Heritage Savings and Loan of Bloomington, and First Suburban Bank of Maywood, when the nominee loans became non-performing, the assets were taken back into the institution, again sold at inflated prices to straw purchasers, financed by the institution, in order to inflate the net worth of the bank or savings and loan. The clear purpose was to keep the federal regulatory agencies at bay by maintaining a net worth above the trigger point for forced reorganization or liquidation.

Probably most common, however, is simply adjusting the accounting books to shield the thrift from regulatory action. At one savings and loan,

three irreconcilable sets of records were kept, two on different computer systems and one manually. The FHLBB aided ailing thrifts engaged in fraud to cover-up their illegal and unethical activity by establishing a number of bookkeeping strategies during the deregulatory period that provided the industry with the tools to juggle their books.

In 1981, the FHLBB developed and encouraged the use of new accounting procedures known as regulatory accounting procedures (RAP). The new procedures entailed a complex formula allowing for the understating of assets and the overstating of capital. The sole purpose of the new RAP techniques was to inflate an institution's capital-to-assets ratio, thereby bolstering its image of financial health, and warding off reorganization, which the FSLIC increasingly could not afford. The procedures created a gray area where the thrifts could commit fraud without detection, but it also sent the message that the board permitted deceptive accounting. The FHLBB failure to issue appropriate guidance on how to treat ADC transactions for accounting purposes resulted in the FHLBB sending the implicit message that it implicitly condoned accounting practices that increased a thrift's net worth, that is, encouraged accounting treatments of ADC transactions that inflated the net worth of thrifts.

Thrift fraud went relatively undetected by regulators, and was generally not dealt with through formal actions. This was partly due to the regulator's belief in deregulation and that the market would regulate thrifts, and that government intervention was not necessary.

Compounding the problem was that the resources of the FHLBB for examining thrifts remained constant for 20 years, despite the increased number of thrifts. In 1966, when the total assets of thrift institutions were \$133.8 billion, FHLBB had a field examination staff of 755 persons; by 1985, when total assets had soared to \$1 trillion, the examination staff stood at 747. Despite repeated requests by the FHLBB for budget increases, the Office of Management and Budget (OMB) refused to increase the FHLBB's budget. In 1985, OMB finally agreed to increase the FHLBB's budget, but this was too little too late.

It is clear that politics played an important role in the fraud committed by savings and loans: It has been charged that M. Danny Wall, head of the FHLBB at the time, met personally with Charles

Keating, owner of Lincoln Savings and Loan, and intervened on behalf of Keating to ward off FHLBB regulators in the San Francisco district who were investigating the thrift. Wall managed to move the investigation from the San Francisco office to Washington, D.C. and to delay closure of the insolvent thrift for two years, a delay that is estimated to have cost the FSLIC insurance fund \$2 billion.

Thrifts used their tremendous influence to enlist members of Congress to their cause of covering-up fraudulent activity. For example, just before the Lincoln case was moved to Washington, D.C. five U.S. Senators who had received campaign and other contributions from Charles Keating, called San Francisco regulators to Washington, D.C. to "discuss" their prolonged examination of Lincoln.

Political influence and corruptions were not the only factors that allowed the use of thrifts as an instrument of illegal fraud. There were more general structural forces complicating the uncovering of the fraud by federal regulators. The basic structural flaw permeating the FHLBB system was the conflicting responsibility of promoting the industry, while regulating the industry, and simultaneously insuring deposits of those thrifts.

The FSLIC, charged with insuring thrift deposits and paying depositors of any thrift that became insolvent or unable to pay its depositors, had no legal authority to monitor or supervise the institutions and had to receive approval from the Bank Board before it could take any final action. Making matters worse, the FHLBB was responsible for chartering new thrifts and promoting the general welfare of the savings and loan system, yet at the same time was the main thrift regulator.

Another structural problem that resulted in the FHLBB and its examiners being reluctant to close a failing thrift was that the FSLIC lacked the money to pay off all depositors of thrifts, that it would close. By 1986, the FSLIC itself was insolvent (its liabilities exceeded its assets by an estimated \$3 billion to \$7 billion), drained of its resources by the epidemic of thrift failures.

Throughout the 1980s, the FHLBB had extended forbearance to ailing thrifts, forestalling their closure or reorganization, either because it believed the thrift to be capable of recovery in the new deregulated environment, or because the regulators desired to postpone using insurance fund reserves. When the fund itself became insolvent in 1986, forbearance became a matter of necessity. As the

FSLIC stopped closing insolvent thrifts, not only did the final costs escalate, but fraud, which in many cases had contributed to the insolvency in the first place, went undeterred. With nothing to lose, careless risk-taking and looting permeated the institutions until they were finally, mercifully put out of their misery.

Savings and loan fraud is clearly white-collar crime on a grand scale, although it does not fit neatly into one of the categories of white-collar crime defined by sociologists and criminologists of state crime, corporate crime, and financial crime. However, it does underscore that the problem of defining white-collar crime continues today.

#### SEE ALSO

scams; Keating Five; Keating, Charles; bank fraud; accounting fraud.

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## scams

SCHEMES, FRAUDS, scams, and cons are devices by which one party defrauds another of a desired object, usually cash. In some scams, victims are willing participants, hoping to gain an unfair advantage over someone else (Nigerian fraud, winning lottery ticket, etc.) while in other scams victims are unwilling participants (home repair, bank examiner, bumper cars, etc.)

Unwilling participants are often selected because of their age, ethnic heritage, or apparent naivete. Often willing participants are hesitant to file criminal charges, as are other scam victims who are too embarrassed to admit they were duped. Scams range in nature from the feasibly possible (merchandise at slightly under cost, lost pet) to

those that are physically impossible (money-making machine.)

The people perpetrating the scams are hoping to identify certain characteristics in their victims: desire for excitement, greed, compassion, or lack of confidence. Perpetrators of scams and cons become quite adept at quickly identifying their next victim or "mark." Similarly, they will often quickly cancel an attempted scam if they note hesitancy by the potential victim. Many scams often follow a scripted format, with each step designed to draw the victim further into the scam. The steps are put into operation as follows: locating a mark, a victim is identified both by personal characteristics and the amount of money they control; playing the con, gaining the confidence of the mark through various subterfuges; roping the mark, drawing the mark further into the scam often through the use of partners, sometimes acting as uninterested bystanders and other times as participants; telling the tale, giving the victim "the inside scoop" on how they can profit from the venture; putting on the touch, the scam is executed and the victim is relieved of funds; losing the mark, the victim is separated from the scam operation, often not realizing that she has been the victimized.

Some common, specific types of perpetrated scams are described below.

**Advance fee scam:** This is a generic scam, sometimes identified as the Nigerian 419 scam, in which a person is requested to pay an advance fee for paperwork processing, taxes, or bribes in order to receive a much larger amount of cash later. In many cases, the money is allegedly coming from less than legitimate business transactions and that is the reason the cash payments are required. The scam is usually repeated, requesting additional payments, as new glitches to the transfer of the larger amount have occurred. The amount of the money promised to the victim is often said to be in the millions, so that payments of only a few thousand dollars seems to be a wise "investment."

**Advertising materials scam:** Businesses are approached concerning an exceptional deal on advertising materials (placemats, pens, calendars, etc.) but after payment is made no materials are received.

**ATM repair:** In this scam, an official-looking repair technician arrives at a location (convenience store, gas station, shopping mall, casino) that has an automatic teller machine (ATM) terminal and proceeds to work on it with a computer keyboard.

After some time working on the machine, the fraudster approaches an employee on duty and asks to use the telephone to call the maintenance supervisor. The caller explains that the ATM is in need of shop repair and to send over a service truck. A service truck appears shortly and the technicians remove the ATM and clean up the area. In some cases, the “supervisor” will call to the location to speak to the “technician.”

*Bank examiner scam:* A “bank examiner” contacts the victim notifying him that a teller at their bank branch is suspected of theft from customers, and the examiner is in need of a regular customer to assist in the investigation. The victim is asked to go to the bank and remove a specific amount of money from a specific teller and then meet the examiner.

The examiner will inspect the money and give a receipt as well as the serial numbers of the bills “held” for evidence. In a deviation on the scam, a “bank examiner” will ask persons leaving a bank to allow him to inspect the cash they just received. The bills will be identified as counterfeit and a receipt will be given, along with a promise of contact by a supervisor.

*Illegal alien lottery scam:* A victim is approached by a person, speaking broken English, who explains that he has a winning lottery ticket but cannot redeem it, as he is an illegal alien. In exchange for a lesser cash amount he will surrender the ticket to the victim. To often convince the victim of the value of the ticket, a copy of the local newspaper with the winning number is shown to the victim; however, the ticket being offered was purchased the day after the drawing.

A variation on the scam is that the holder of the winning ticket of the lottery from his home country (Spain is often mentioned) is either wanted in his homeland or is hiding in the United States due to political persecution and therefore cannot cash the ticket.

*Big carrot scam:* A scam that usually occurs in a busy shopping mall in which a person affiliated with one of the anchor stores informs you that his store is grossly overstocked with certain items and that they need to sell them out at below cost, but the shopping center has rules concerning under cost sales. The salesperson agrees to take your money, go inside and transact the sale and bring the merchandise back. He enters the store but never returns, escaping out the back of the store.

*Begging scams:* A generic scam in which a person assumes any of a multitude of personae (homeless, veteran, unemployed, physical or mental illness) or conditions (vehicle broken down, medical bills, etc.) to plead for money.

*Bogus invoices:* Companies, especially those with multiple locations, receive invoices for the alleged receipt of goods (office supplies, safety materials, etc.). No goods were ever received but some companies pay the invoices out of lack of internal accounting controls and fear of litigation.

*Bumper cars:* In this scam, a victim (usually an older driver or someone leaving a bar) is involved in a staged accident and a third party approaches and states that the victim was clearly at fault. The other driver claims some minor injury and vehicle damage. Out of fear of a police report and an insurance claim, the victim pays the other driver the amount requested for damages. In variations of this scam, the victim is contacted again and informed that the actual damages were higher and additional funds are required; and other times, if the victim is low on cash they are encouraged to give a credit card as collateral until they can get the cash.

*Catalog 10-and-10 scam:* In this scam, a representative of a nationally known company approaches homeowners advising them of a national sale going in their area to improve the company's market share. In an attempt to increase sales, the representative is authorized to give discounts up to 50 percent off the usual price, and the customer only has to pay 10 percent down and 10 percent shipping costs to the representative and the order will be placed. Of course, no such shipment ever occurs.

*Chain letter scams:* A deviation of a pyramid scheme in which a recipient is encouraged to send money to the names on the list and add her name to the list. The letter promises a large return on the “investment” in a short time; however the original names on the mailing are the names of the scam operators.

*Change machine scam:* A scam in which an authentic-looking change machine is placed near vending machines. The machine will accept bills but returns no change. As most losses are low, the majority of victims either walk away or may leave a note advising that the machine is not working properly. The person running the scam removes the note after the victim leaves. In a technological improvement on this scam, authentic-looking ATM ma-

chines are placed in high foot-traffic areas. Victims place their credit cards in the machine as well as type in their personal identification numbers (PINs) but are advised that the ATM is out of money. The operator of the fraudulent ATM later removes the machines and has the victims' credit card information as well as their PIN.

*Coin con:* A person is approached by a young man, who often appears to be confused, and is shown a roll of coins with a note advising to call the listed number for a reward. Upon calling the number, the person is advised that there is a \$500 or more reward. Most victims mention the person who handed the roll to them. The caller is asked to give the "confused" young man \$100 and is given an address to bring the coins where they will be reimbursed for the \$100 and paid the remaining reward. Of course, no such address exists.

*Fast change scam:* In this scam, a customer at a retail location makes a purchase and pays with one denomination bill and, as the cashier begins to make change, offers another denomination bill instead. This occurs several times during the transaction and when the change-making process is finally completed the cashier's register is short.

*Fortune teller handkerchief scam:* A fortune teller, who has slowly been gaining the customer's confidence, advises the customer that the only way to rid themselves of bad luck or karma is to dispose of a large sum of money; which they will reap tenfold in other ways. The fortune teller produces a handkerchief, sewn at two ends, into which the money is placed. After sewing the handkerchief entirely closed and speaking some words over it, the customer is advised to go to a nearby disposal point (bridge, cemetery, body of water) and get rid of the handkerchief. Unbeknownst to the customer the fortune teller switched the handkerchief with the money for another containing paper.

*Gold brick scam:* A person is approached by someone who asks them to hold a gold ingot for them for an indeterminate period of time, as the owner will be incapacitated for some time. In a gesture of good faith a small amount of money is asked for as "good faith" money. When the victim closely inspects the gold bar, it is discovered to be an iron ingot plated with a gold-colored material.

*Home inspector scams:* A generic scam type, often perpetrated upon older homeowners, in which a person posing as a municipal inspector (from the water, gas, or electric company, for example) ap-

proaches a homeowner and advises her that the residence is in violation of an ordinance. The scam can proceed to several directions at this point, with the inspector referring a contractor that he knows is in the neighborhood, or collects the money himself agreeing to send a municipal crew the following day to make the repairs.

*Home repair scams:* In this generic scam usually executed upon older homeowners, itinerant laborers offer to perform various home repairs for exceptionally low prices. The scam has many variations: they simply use the ploy to enter the house and steal valuables; they fail to finish the job the first day and request payment promising to return tomorrow; one of the workers injures himself and demands money for medical treatment; or once the work is completed the price is inflated (owner heard wrong, additional repairs had to be performed, extra materials were required, etc.) In cases where repairs are actually performed, the work and the materials are often substandard.

*Jamaican handkerchief/envelope scam:* A variation of the pigeon drop scam in which two persons impersonate newly arrived Jamaican immigrants. The scam works as follows: Con man 1 approaches the victim and asks (in broken English) for directions and pulls out a large roll of bills and gives the mark \$50; con man 2 approaches the pair and states that it is unsafe for a newly arrived immigrant to carry that much money and offers to hold it; con man 1 states that he doesn't trust con man 2 but for some reason trusts the victim; he pulls out the roll of money placing it in a handkerchief and gives it to the victim; he then mentions he would feel more secure if the victim placed his cash in the handkerchief also—so the victim would protect the handkerchief like it was his own; after the victim places the handkerchief in his pocket one of the con men explains that it should be positioned differently and they remove the handkerchief; after a sleight of hand the victim is given the handkerchief again (now with no money, just paper).

*Money-making machine scam:* This is a scam that, in spite of its improbability, has been successfully executed upon business persons. In the operation, an inventor has created a machine that not only perfectly reproduces money, it scrambles the serial numbers to circumvent the problems counterfeiters encounter, that is, multiple bills with the same serial number. The only "drawback" to the process is the time (1–2 hours) it takes to process a bill. To con-

vince the victim that the process does work, the fraudster allows the victim to insert two paper trays, one with plain paper and one with actual currency into the machine. Then, both leave. Unknown to the victim, the machine actually works from a second concealed tray, in which another real bill has been placed.

When both the inventor and victim return to the machine, the victim is allowed to check the machine and finds both the bill originally placed there as well as the newly “made” bill. The victim is encouraged to go to his bank and check the authenticity of the second bill. Once the customer is convinced that the machine works as promised, the sale is made. In many cases, the inventor has placed a few other legitimate bills in the hidden compartment delaying the discovery of the con.

*Lamborghini test drive:* A scam often offered around the winter holiday season in which individuals are offered the opportunity to drive a Lamborghini for 30 minutes in exchange for a small payment (for insurance purposes only) to do some “street advertising” for the car. If an hour block of time is purchased, for \$400 the purchaser will also get an hour in a Dodge Viper as part of the package. Payment is made and the buyer is told to be at a prescribed location, with his valid driver’s license, the following day. In some cases, advertisements are run in local newspaper, later found to be paid with forged checks.

*Lonely hearts scam:* A scam in which, after a mail relationship has been established, money is requested in ever-increasing amounts to facilitate efforts for the romantic pair to finally meet. This is a scam often run by prison inmates who create elaborate stories to obtain additional funding, while normally concealing the fact that the letter writer is incarcerated. In one noted scam from Angola Prison in Louisiana, over \$500,000 was made using this format.

The victim would first send airfare, then receive a telephone from the airport police advising that his friend was arrested due to a fight and bail money was needed. The victim would receive a subsequent call noting that the friend was injured in an altercation in jail and medical expenses were needed. If the victim became aware of the scam or refused to pay additional monies, the scam sometimes progressed to extortion.

*Lost pet scam:* A scam that is performed upon pet owners who have posted lost pet ads. In one

common adaptation of this scam, a caller informs the owner that she has found the lost pet—in their moving van now several states away. The caller explains that the pet must have jumped into the moving van as it was being loaded near the owner’s residence. In order to “swing” back to the owner and return the pet, the fraudster needs some fuel money wired immediately.

The caller recommends Western Union, and to make sure the caller isn’t scammed out of her money, the pet-owner should send the money with a test question, for example, the pet’s name. By sending money in this manner, the caller is able to collect the money without showing identification and can retrieve it at any Western Union outlet, often in the city where the funds were sent.

*Fax fraud:* Businesses receive a request for pricing on services or sales, and the information must be returned via fax. The letter indicates a serious interest in conducting business and an immediate response is required. The out-going fax number turns out to be from a foreign country resulting in an exorbitant long-distance phone line charge.

*Melon drop scam:* A scam often perpetrated on tourists in which a person intentionally “bumps” into the victim and drops an item, often a champagne bottle filled with water. The scammer then proceeds to accost the person who “made” them drop the champagne until the victim is so intimidated that he pays for the damaged merchandise. Another participant may intercede as a witness agreeing that the victim caused the accident. This scam is often perpetrated on Japanese tourists using melons for the merchandise. Japanese nationals are accustomed to paying as much as \$35 to \$50 for melons in their country.

*Murphy game:* A scam that originally had involved prostitutes, but now has extended to other areas. In the original scam, a person posing as a pimp would bring the victim to a hotel lobby and say that, to avoid problems with the police, he would handle the money transaction. After the agreed upon price is paid, the victim is sent to a hotel room soon to find that no prostitute was waiting for him. In a variation of this scam, a prostitution date was arranged but a “police officer” would burst into the room before any sexual activity took place. The police officer would agree to accept a cash bribe in exchange for not making an arrest.

A current version of the scam now involves a “middleman” story in which high priced electron-

ics, clothing, or equipment can be purchased from a friend on the loading dock. The victim, sometimes renting a truck in expectation of a large purchase, and the middleman drive to the warehouse where the victim is informed that for secrecy reasons, the victim cannot meet the inside man, and must give the middleman the cash to bring inside to the inside man. The middleman proceeds to enter the loading dock area as if looking for his contact but once out of sight leaves through another door.

*Nigerian 419 scam:* A scam in which a person is contacted, usually by e-mail or fax, and is informed that for his cooperation in removing a large sum of money (proceeds of illegal oil sale, hidden assets of deposed leader, overage on government contract) from, Nigeria he will be given a percentage of the gross amount. All that is needed from the victim is a bank account into which the funds can be transferred; and possibly some other banking information all sent back to the Nigerian contact. The scam sometimes evolves to the Nigerian advance fee scam, when due to complications, some upfront money is now required. Once the victim's bank account routing number is gained, the account is depleted of funds rather than funds being placed in it.

*Obituary scam:* This is a swindle in which information is obtained from a local newspaper obituary column and a package is then brought to the home of the deceased, or relative of the deceased noted in the column. The package was insured and came with a small amount due, which has to be paid before the package is released. Another variation of the scam involves services that were partially paid for by the deceased, but for which there is an outstanding balance.

*Pager/cell phone scams:* A digital or voice message is left on an individual's cellphone or pager indicating an urgent matter. When the return call is made to the number given, the caller is placed on hold; and later when the bill arrives a charge is noted for either a service charging a per-minute fee or an international call.

*Pedigree dog scam:* A person enters a business, often a bar, and pays the bartender to watch his dog for a few minutes as he is going to a "very" profitable business appointment. After the "businessman" leaves, another patron arrives shortly thereafter and begins admiring the dog, stating that he has been looking for that exact dog for some time and would pay handsomely, dropping the figure of \$600, leaving his business card and telephone

number. That patron departs and shortly thereafter the "businessman" returns looking sullen saying that his deal fell through and he is totally broke. If the mark has been properly selected (subject to greed) the bartender will offer to help the businessman by purchasing the dog (for much less than the other patron had offered.) The other patron is not to be found, however.

*Pigeon drop scam:* A commonly run street scam in which a participant of the scam "notifies" a bag/bundle/wallet on the ground just as the mark approaches. Upon opening the package, a large amount (several hundred to several thousand dollars) of money is noted. While discussing what to do, another participant of the scam arrives posing as a bystander. He happens to know a lawyer who they can contact. After making a call to the lawyer, it is learned that they must hold the money for 30 days (state law) and if no claims are made, they can keep it. The decision is made to let the victim hold the money, but so they can all trust each other each should put up an equal sum of money. The two participants of the scam just happen to have their share on them. They agree to go with the mark to get his share, and once it is obtained all the money is placed in a cloth sack and handed to the mark with details given to meet again in 30 days. However, as the result of sleight of hand, the mark is now in possession of a folded cloth containing cut up newspaper.

*PBX phone scams:* A business receives a telephone call advising the PBX (telephone system) operator who answers that a problem exists on the line and the PBX operator needs to punch in 90# so the line can be tested and repaired. Later, several unauthorized long-distance charges will be noted as the PBX operator unintentionally granted long-distance access to the caller.

*Slamming:* Without approval of anyone in authority, a company's telephone service has been switched resulting in excessive charges. As an offer of proof of authorization to make the change, the offending company may offer an audio tape of an employee saying "yes," but not to the authorization, but rather some inane question posed of the employee in an innocuous conversation, and tape-recorded.

*Charity scams:* A request to make a donation to an apparent worthy cause, for example, police department, fire department, disaster survivors, disabled children groups, etc. However, the group

making the solicitation has no official connection to the causes the fraudster claims to represent.

*Ponzi/pyramid schemes:* Two different scams which are somewhat similar in nature in that both profess that wealth will be produced by the entrance of either more people or more levels into the operation. Victims are promised great returns and are often paid with the monies supplied by new victims. As the scam proceeds, the victims are encouraged to leave their monies in the operation to achieve even greater returns. As the scam cannot mathematically succeed due to the ever-increasing number of new members needed, the scam eventually fails and the participants lose their "investments."

*Recovery operation fraud:* An individual, who is the victim of an earlier scam is contacted, by a recovery specialist who is involved in efforts to either recover the victim's prior losses through a fee-based operation or through the continued "cooperation" with the original scam to assist in apprehending the original fraudster. Either operation causes the victim to be scammed a second time.

*Spanish prisoner scam:* This is a scam that dates back to the 1500s in which an unjust imprisonment has occurred in a foreign country, and unless funding is received for both legal defense and bribes, the prisoner will probably die in prison. The letter, which has been smuggled out of prison, has the name and post office box of a friend of the prisoner where money can be sent. The letter further states that the generous souls who donate money will be repaid "multiple times over," as after the prisoner obtains his release he will have access to a large cache of money in the United States, and will generously reward his benefactors. Thousands of copies are mass mailed and the response rate is amazingly high.

*Three card monte/shell game:* A street scam in which the position of a card or token is wagered upon. Through sleight of hand maneuvers, the victim is allowed to win several times with the bet slowly being raised. After the bet has been risen sufficiently, to a point where the victim may leave if it goes much higher, the same sleight of hand now causes the victim to start losing. Due to his earlier winning streak the victim attempts to recoup his "winnings" only to continue to lose.

*You have won a prize scam:* In this generic scam type, a victim is informed that she has won a prize of substantial value and must only pay a small

amount for shipping to receive the prize. In some cases, the scam is perpetrated a second time explaining that the item was shipped to the wrong location and a small additional fee is needed.

#### SEE ALSO

Ponzi schemes; telemarketing fraud; bait-and-switch; contractor fraud; sweepstakes offers; savings and loan fraud; bank fraud; Better Business Bureaus.

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## Scandinavia

SCANDINAVIA IS A region of northern Europe consisting of Sweden, Norway, Finland and Denmark, with Iceland also included occasionally for reasons of cultural proximity. In recent decades, these countries generally have established a reputation for a high-class welfare state, funded by comparatively high levels of taxation and with neutralist international tendencies that have not hampered efforts to contribute to international peace and reconciliation efforts but does translate into a certain skepticism about international political organizations such as the European Union. Welfare state provision has meant a comparatively low level of underground economic activities and low misuse of migrant workers.

The Scandinavian countries consistently rate amongst the nations with the lowest levels of corruption and other forms of white-collar crime. They have frequently taken a leadership role in the promotion of social responsibility in business ethics and have looked to shape international organizations such as the European Union according to their principles. The ideas that they favor include the use of regulation to require firms to take their



social responsibilities seriously and the use of shareholder and stakeholder interests representatives at board level for similar reasons.

However, research has indicated that there is, nevertheless, a quite high level of fraud throughout the region in some sectors. To try to identify the extent of fraud and to introduce joint policies to help to reduce that level, industries such as the insurance industry have established cross-border initiatives. On some occasions, corporate wrongdoing has been attached to Scandinavian firms as a result of mergers and acquisitions.

For example, the Swedish pharmaceutical company AstraAB merged in 1999 with the British firm Zeneca Pharmaceuticals to form AstraZeneca, which was subsequently prosecuted and fined for conspiring with medical practitioners in the United States to defraud the Medicare system by making false claims for drugs it marketed. In other cases, a more familiar predilection for greed and a febrile internet-backed atmosphere, that provided the opportunity to indulge it, produced a familiar result.

The innovative use of technology has also been a feature of fraud in the region, with one notable case involving the planting of fake automatic teller machines (ATMs) in central Copenhagen, Denmark, used to extract money from unwary individuals.

Scandinavian firms have also been among those accused of wrongdoing in connection with mining practices in resource-rich, but economically underdeveloped areas, although such allegations are also made against mining companies in most world regions.

#### SEE ALSO

Medicare and Medicaid fraud; healthcare fraud; insurance fraud.

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## Securities and Exchange Commission

THE SECURITIES and Exchange Commission, commonly referred to as the SEC, is the primary regulator of the U.S. financial securities markets, and has the overall responsibility for overseeing the federal regulation of the securities industry.

The SEC enforces, among other acts, the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. The SEC works closely with many other institutions, including Congress, other federal departments and agencies, the self-regulatory organizations (the stock exchanges), state securities regulators, and various private sector organizations.

The SEC was created in 1934 as a governmental response to the massive stock manipulations and frauds that helped lead to the famous 1929 stock market crash. During the 1920s, the American dream of rags-to-riches was very successful in bringing millions of individual investors into the stock market. When the stock market crashed in October 1929, the market lost almost 89 percent of its value. Thousands of shareholders lost extraordinary sums of money and soon banks and businesses started to collapse.

The stock market crash and the subsequent Great Depression led to a massive loss of confidence among the millions of Americans who had invested on Wall Street. After the crash, Congress conducted hearings to determine the public's faith, or lack of faith, in the capital markets. Based on the findings, Congress passed the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act).

The SEC was established as a result of the 1934 Act, which empowered the SEC with broad authority over all aspects of the securities markets. The

commission's main purpose was to restore investor confidence by ending misleading trading practices and stock manipulations. President Franklin D. Roosevelt appointed Joseph P. Kennedy, future President John F. Kennedy's father, as its first chairman. The power of the commission extends to registration, regulation, and oversight of brokerage firms, transfer agents, clearing agencies, and self-regulatory agencies. Most importantly, the SEC is responsible for investigating and initiating action when federal securities laws are violated and securities frauds are committed.

There are five commissioners who are appointed by the president with the advice and consent of the Senate. To ensure the commission's impartiality, no more than three of the commissioners can belong to the same political party. The commissioners cannot engage in any other business, vocation, or employment. The commissioners cannot participate in any stock market operations or transactions which are regulated by the SEC. Each term for a commissioner is five years and is staggered relative to the other commissioners. The president appoints one of the commissioners as chairman, the SEC's top executive. The SEC is an independent policing agency with quasi-legislative and quasi-judicial powers.

The commissioners meet to discuss and resolve a variety of issues the staff members bring to their attention. They are responsible for interpreting federal securities laws, amending existing rules, proposing new rules, and enforcing laws and rules. The SEC is supposed to be independent from any influence by representatives of the Executive or Legislative branches of the government. The president has no power to remove any member of the SEC unless he is "inefficient in neglect of duty or malfeasant in office."

## STRUCTURE AND ENFORCEMENT

There are four divisions under the commissioners: the divisions of corporate finance, enforcement, investment management, and market regulation. The commission also has 18 offices, including the offices of administrative law judges, the chief accountant, compliance inspections and examinations, economic analysis, investor education and assistance, and 11 regional and district offices throughout the country. Altogether approximately 3,100 staff members are spread throughout the SEC headquar-

ters in Washington, D.C. and regional and district offices. Crucial to the SEC's effectiveness is its enforcement authority. The division of enforcement, the largest division in the SEC, is responsible for investigating possible violations of securities laws, recommending commission action when appropriate, either in a federal court or before an administrative law judge, negotiating settlements on behalf of the commission, and reviewing cases for possible referral to the U.S. Department of Justice for criminal prosecution. The enforcement division also cooperates with other divisions and offices in the SEC, as well as other domestic and foreign authorities and organizations, for its enforcement work.

There are primarily three sources from which the SEC enforcement division detects or becomes aware of possible violations of the securities laws. A large part of the SEC cases are the result of referrals by the self-regulatory organizations (SROs) which include the securities exchanges such as the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX), and the National Association of Securities Dealers (NASD) which regulates the over-the-counter securities market. Many of the cases have come from tips provided by informants or complainants. Insiders, such as company executives, who suspect possible violations, may call to inform the SEC of the unusual trades. To encourage more people to report illegalities, the SEC provided a bounty for informants whose tips lead to the conviction of an offender. Finally, the enforcement division, in cooperation with other relevant divisions and offices in the SEC, proactively searches for illegal behavior by scanning the press reports for clues, or conducts its own surveillance activities.

Whatever the source that reports the potential illegalities, the enforcement division must make the decision whether or not to investigate. The division's staff will check to see if the person under investigation has had problems in her trading history. They may also obtain facts through informal inquiries, interviewing witnesses, examining trading records, and other methods. If the facts show that no violation has been found, the informal inquiry is concluded. If the staff members find it necessary to proceed, they will present a staff report to the commissioners for their approval for a formal order of investigation. Once the commission issues a formal order of investigation, the enforcement officials have the power to subpoena individuals or entities

to obtain sworn testimony and relevant documents. In most cases, since it is difficult to find eyewitnesses to testify against a potential violation of securities laws, cases are primarily based on circumstantial evidence. For example, in insider trading cases, telephone records of insiders may be subpoenaed to see if there were conversations between certain individuals.

Illegalities originating in foreign countries make detection and enforcement even more difficult because some countries have bank secrecy laws or blocking laws which prevent the SEC from obtaining a trading account or the account holder's information. The SEC has made great effort to deal with such problems by signing agreements with foreign exchanges, and memoranda of understanding and treaties for mutual assistance in criminal cases. However, not every country has an agreement with the SEC regarding mutual assistance for investigating transnational cases. Even with the agreements, the SEC must present a very clear case before a foreign country is willing to provide assistance.

## GOING TO COURT

Following an investigation, the SEC staff will close the case if they decide that sanctions are not necessary, or otherwise make a recommendation to the commissioners that enforcement action be taken. The staff presents to the commission the facts of the case and its reasons for pursuing sanctions. SEC commissioners determine not only whether to take actions against the perpetrators, but also the options of action to be taken. The commissioners' deliberation in prosecutorial discretion is conducted confidentially. The kinds of issues considered by the commission in deciding how to proceed include: the available evidence, the technical nature of the case, the seriousness of the wrongdoing, the type of sanction or relief to obtain, the deterrent effect a prosecutorial decision might have on potential law breakers, and the impact of prosecutorial decisions on the development of policy.

After their deliberation, the commissioners may authorize the staff to file a civil case in federal court, bring an administrative action before an administrative law judge, or refer the case to the Justice Department for criminal prosecution. For civil cases, the commissioners review the material before them and decide whether charges should be laid or amended. The administrative proceeding is a public

or private hearing, ordered by the commission, and presided by an administrative law judge, who is independent of the commission. Administrative law judges consider the evidence presented by the enforcement staff and the subject of the proceeding. Following the hearing, they recommend a disposition based on their findings of fact to the SEC commissioners, who determine the final disposition. Among other actions, administrative law judges issue subpoenas, rule on motions, and rule on the admissibility of evidence.

The commissioners may affirm the decision of the administrative law judge, reverse the decision, or remand it for additional hearings. The defendant may request an oral argument before the commission or appeal all or any portion of the SEC decision to the federal courts. The administrative sanctions include cease-and-desist orders, suspension or revocation of broker-dealer and investment advisor registrations, temporary suspensions of business and employment, censures, bars from association with the securities industry, alterations in the management structure of the organization, restrictions on business practices, payment of civil monetary penalties, and return of illegal profits.

Civil actions are initiated by SEC staff in the federal district courts. The staff files a complaint with a federal district court that describes the misconduct, indicates the laws and regulations violated, and proposes the sanctions or remedies. Typically, the commission requests the court to issue an injunction decree, which enjoins offenders from future violations of the securities laws or SEC rules.

The commission may also request the court to impose ancillary remedies, such as asset freezing, civil monetary penalties and the return of illegal profits, known as disgorgement, and suspension of an individual from employment. Failure to abide by an injunctive decree can result in criminal contempt proceedings. Each year the SEC brings 400 to 500 civil actions against securities lawbreakers. Typical offenses pursued by the SEC include insider trading, accounting fraud, and misleading statements about securities and the companies that issue them.

The person charged may alternatively choose to settle the case before the charges are filed in court. In fact, a settlement is a typical result of enforcement actions by the SEC. In most settlement arrangements, the defendant agrees to a civil penalty without admitting or denying the SEC's allegations.

Such a settlement is a benefit to both the defendant and the SEC in terms of cost and time saved. The terms of a settlement must be approved by the commissioners in administrative cases, and by both the commissioners and the U.S. District Court in civil cases.

Normally, a settlement with the SEC does not preclude criminal prosecution. In some cases, however, a defendant will propose a civil settlement which provides that the SEC shall not pursue the case criminally. The SEC's litigation experience is relatively rare, with only about 12 percent of the cases litigated and approximately 80 percent settled by consent.

## PROSECUTION

In most cases, SEC staff decides whether criminal prosecution is appropriate, and the commission formally refers the case to the Justice Department, which has the discretion to accept or decline the case for criminal prosecution in the federal district courts. Some researchers who examined the SEC's prosecutorial discretion found that only about 10 percent of the SEC cases are referred for criminal prosecutions.

The reasons may include the difficulty in proving the case, limited enforcement powers, limited resources, and the commission's lenient ideology against securities law violations. Driven by high service fees, in contrast, attorneys for securities offenses usually get involved in such cases as early as the investigation begins. They prepare their cases with painstaking attention to detail, often employ the services of other professionals, and spend great effort to prevent charges from being filed.

Because there are various checks to ensure that the cases pursued are clearly strong ones, defense attorneys have various opportunities at each stage to encourage the SEC to drop the cases. Therefore, the SEC prefers instead to resolve cases by various other means, especially by administrative proceedings. In many decades of its operation, the SEC has been criticized by some as unnecessary, but by others as insufficiently effective. In the years before the late 1970s, it was seen as retreating from its traditional role as protector of investors and progressed little in its enforcement. In the 1980s, however, the SEC achieved power and respect for its vigorous pursuit of insider trading. In the 1990s, it further strengthened its enforcement efforts against various

forms of financial crime. Political heat stoked by corporate scandals has made the SEC reluctant to settle or close out cases without imposing fines or some other punishment.

By the 2000s, the growing volume of enforcement actions by the SEC was putting the policing agency in a real bind, because it did not have enough staff to keep up with the volume of cases it had already opened. Congress was on its way to help the SEC with the caseload problem by substantially increasing the agency's budget. With its long tradition of aggressive actions, it is possible that the SEC will achieve more efficient and effective enforcement of the U.S. federal securities laws.

## SEE ALSO

insider trading; securities fraud; accounting fraud; bank fraud; prosecution; reform and regulation; United States; Roosevelt, Franklin D.; capitalism.

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## securities fraud

**SECURITIES FRAUD** refers to the criminal conduct of persons involved in the purchase and/or sales of stock shares in both publicly and privately held companies, as well as other financial instruments, including bonds and commodities. The word security refers to a monetary interest in a company, such as: an investment contract, voting trust certificate, options to purchases stock in a company, interest in oil, gas, water, or mineral rights; as well as stocks and bonds. Federal securities laws, primarily the Securities Act of 1933 and



*Collusion to raise a stock's price can include false claims of breakthroughs.*



*Corporate tax evasion using offshore entities is a form of securities fraud.*



*Corporate debacles, such as Enron, cause share prices to plummet.*

the Securities Exchange Act of 1934, regulate the conduct of both brokers and stock exchanges. Shares of publicly held companies are normally purchased and sold on one of several exchanges, including: the New York Stock Exchange (NYSE), NASDAQ which is operated by the National Association of Securities Dealers, Inc. (NASD) and handles many high technology stocks as well as “over the counter” (OTC) shares; and other smaller exchanges. Security fraud can involve the actions of individual stockbrokers, company officers, internal or external auditors, or joint efforts of multiple brokers at the same or different firms. Security fraud cases can result in both civil and criminal sanctions. In the early 2000s, due to downward stock market trends, an increase in security fraud allegations was noted; however, security fraud does not apply to all losses incurred in the stock market, only those with criminal actions attributable to persons involved in fraud.

The crime of securities fraud was much publicized with the cases of Adelphia Communications, Enron, ImClone, Tyco, and WorldCom. Another noted case involved a 15-year-old from New Jersey who generated \$285,000 in profits from a pump and dump scheme. Profits and greed are the drivers behind securities fraud as articulated by stock trader Ivan Boesky in his quote to the 1986 commencement address at the University of California, Berkeley: “Greed is all right, by the way ... I think greed is

healthy. You can be greedy and still feel good about yourself.” Specific security fraud crimes cases are delineated as follows.

### PUMP AND DUMP

A securities fraud type often utilized in “boiler-room” operations (stock sales operations specifically established to perform pump and dump scams), and on internet bulletin boards. In a typical pump and dump scheme, the operation purchases large blocks of stocks in small, thinly traded companies, and then promotes the company’s stock with misrepresentations and false statements. Comments such as the following are often utilized: “this is a sure thing; the company is about to announce a merger”; “we will monitor your account and control your losses”; and “our owner just made a large under the table purchase himself.”

Once the widespread high-pressure selling begins to increase the price, the stock becomes a self-fulfilling prophecy and more buyers purchase blocks of stocks. The fraudulent information campaign continues until the operators decide to sell their large blocks of stocks. Once the boiler-room/bulletin board operation stops, the price of the investment falls as it is no longer pushed for investment. At that point the investors lose their money as the price returns to the point it was before the fraud was initiated. Pump and dump schemes

have been conducted by single individuals, groups of collusive brokers, and by organized crime groups.

In some cases, owners of the involved companies have orchestrated the pump and dump. The Securities Exchange Commission (SEC) obtained several criminal convictions and recovered approximately \$11 million in a case against the owners of Systems of Excellence, Inc. The owners sent out false press releases over the internet and bribed stock analysts to tout the stock; after they secretly distributed over 40 million shares to friends and family. In another SEC case, Sloane Fitzgerald, Inc. sent out six million unsolicited e-mails and created a phony online newsletter to promote two thinly traded companies. Sloane Fitzgerald had been contracted by the two pumped companies and paid in cash for their services.

## INSIDER TRADING

In this securities fraud, the purchase or sale of shares is made subsequent to acquisition of information not known to the general public. Insider trading is the use of pertinent, nonpublic information to impact the sales of securities. The guilty parties can be insiders (owners, officers, directors, employees) of the company involved; the persons who make the purchases for themselves or as “shills” for the insiders; or independent parties (printers, couriers, outside legal contractors) who have obtained inside information.

Within SEC regulations, the parties to fraud are labeled as to their involvement: persons who pass on insider information but do not trade shares themselves are called tipplers; persons who acquire insider information themselves, or through the others who have breached their fiduciary responsibilities, are called tippees. Another classification, misappropriators, refers to persons outside the involved corporation, who steal non-public information in violation of fiduciary rules.

A highly publicized insider-trading case involved ImClone Chief Executive Officer Samuel Waksal, media giant Martha Stewart, and her stock broker. According to SEC filings and press reports, Waksal allegedly learned of a pending report from the U.S. Food and Drug Administration (FDA) concerning a medication the company had hoped to sell in the United States. Once the information was made public, the stock price plummeted and in-

vestors lost millions. However, several investors were able to sell their shares before the news release and the subsequent price decline. The investors included members of Waksal's family, as well as Waksal friend, Stewart. It was additionally alleged that, in an attempt to portray Stewart's sale of approximately \$225,000 of ImClone shares the day before the press release as unrelated to the negative FDA report, her stock broker and his assistant were charged with falsifying brokerage house records to show that a previously agreed, pending sale order was in the file.

## RESEARCH AND INVESTMENT COLLUSION

In this potential fraud situation the investment banking (sales) department of a brokerage house utilizes inappropriate influence over the research analysis department. Potentially negative analysis concerning preferred customers is either suppressed or altered to conceal certain negative aspects of the analysis. The inappropriate influence leads to investors being misled about the strengths of the involved companies.

In some cases, analysts are compensated either by the management of the brokerage house or by the company in question for positive research recommendations. An example of this fraud type concerned the continued sales efforts of some brokerage houses to recommend Enron stock while their internal analysis departments determined the stock to be a risky investment. In April 2003, the SEC announced \$1.4 billion in fines and penalties against 10 of the nation's top investment firms for alleged improper activities between research and investment divisions.

## STOCK CHURNING

This type of fraud refers to a securities scam in which a broker performs multiple trades in a client's account not for the advantage of the client, but only to generate additional sales commissions. Churning can occur in both accounts where a broker has discretionary authority from the account holder to make trades on her behalf, and on accounts where the broker does not have discretionary trading authority. In accounts where the broker has discretionary authority, excessive, unnecessary, and detrimental trades are transacted simply to generate sales commissions. In accounts where discretionary

authority is not granted, trades are transacted in selective accounts (those with high profits and minor review by the account holder) so that the trades and subsequent commissions will probably not be noticed. Investors are not only impacted by commissions, but often short-term capital gains taxes if the stocks are held less than the prescribed time.

### UNAUTHORIZED TRADES

This is a securities scam similar to churning but the focus isn't necessarily commission-driven. In some cases, stocks are sold between accounts to cover misappropriation by a stockbroker, that is, if an account holder requests a statement for an account that the broker has stolen from, the broker needs to replace those stocks back into the account. If the account holder notices the in-and-out transaction the broker can claim an accounting error that was caught internally. The account the stocks were obtained from doesn't need to be covered until a statement is requested for that account.

Unauthorized trades may also be conducted by brokers to cover margin calls (stocks that were purchased on credit against the portfolio need to be paid for as the stock price dropped) in their personal accounts; or to simply steal money from accounts.

### PENNY STOCKS

Also referred to as micro-cap and chop stocks trading, these names all refer to the trading of low-priced stocks often involving start-up companies (even though they are labeled penny stocks, the title refers to stocks priced at less than \$5). These stocks are traded on the over-the-counter bulletin board (OTCBB), which on a typical day lists approximately 70,000 stocks.

Micro-cap/penny stock fraud became popular in the 1950s with the sales of uranium mining shares in Utah. In the 1980s, the focus shifted to oil and gas stocks, again in companies with little or no track record. These types of stocks are often sold by unregistered brokers sometimes out of "boiler-room" operations, with limited knowledge of the company's operations and tightly controlled trading. There has been a noted increase in organized crime in the sales of micro-cap stocks. One noted case involved Uniprime Capital Acceptance Inc., which in 1996 began as an auto-financing and insurance company with a daily average of 10,000 shares

at 50 cents. In 1999, an attempt was made to increase the value of the company by touting an HIV (AIDS virus) medical breakthrough in one of its affiliated companies. With the assistance of online chat rooms and bulletin boards, Uniprime increased its daily volume to 5 million shares and traded at a high of almost \$8. Once later information revealed that no breakthrough or affiliated company existed, the stock rapidly collapsed.

### AFFINITY FRAUD

This securities fraud is focused on identifiable groups whose members are chosen as victims because of their membership. The group (church, social group, professional organization) is approached and offered an opportunity that other groups will not be offered. When focusing on church groups, the sales pitch may focus on the good the proceeds can do to help others, or similar religious backgrounds will be professed.

One noted case was *SEC v. Oracle Trust Fund*, in which approximately \$7 million was raised from just over 120 church members. The promoters gained the confidence of the members by claiming to have been born-again Christians, and a prophecy sent them to these particular church members.

### ACCOUNTING FRAUD

This securities scam is often perpetrated by the management of a company, rather than individual brokers; sometimes with the assistance or negligence of internal or external auditors. Specifically, these acts violate several SEC doctrines and laws, including:

*Bespeaks caution doctrine:* forecasts, opinion, or projections must disclose specific risks.

*Duty to disclose:* persons who have made misleading statements must issue corrective statements as soon as they are aware of the misstatement.

*Breach of fiduciary duty:* reasonable decisions must be made concerning corporate and stockholder investments.

The management structure of an organization has an understood duty to both the company (board members and employees), as well as to the stockholders; and as such all statements made by officers of a company must be made in good faith and all accounting information supplied to analysts and stockholders must be accurately presented. In 2002,

the SEC investigated several cases of alleged financial manipulation.

Members of the management teams of Enron, Tyco, WorldCom, and Adelphia, among others, were investigated for various frauds and securities violations. Enron Corporation Chairman and Chief Executive Officer Kenneth Lay encouraged Enron employees to buy Enron stock as the company prospects were very positive. In August 2000, Enron reached an all-time high of \$90.75, and while Lay was encouraging employees and investors to purchase more stock, he was selling his stock (approximately \$100 million according to the SEC).

As Enron stock began to fall, Lay still strenuously encouraged employees to purchase additional stock. Employees eventually were blocked from selling the Enron stock held in their 401K plans. In November 2001, Enron shares closed at 26 cents. Also involved in the Enron accounting scandal were chief financial officer Andrew Fastow and external audit firm Arthur Andersen LLP. Fastow allegedly generated over \$25 million in profits for himself through off-the-balance-sheets partnerships named after his wife and children. Audit firm Arthur Andersen LLP paid a \$7 million fine for obstruction of justice charges for destroying internal memos at the request of Enron after the investigation began and subpoenas were issued.

## UNQUALIFIED REPORTS

The SEC also cited Arthur Andersen for its auditing work with Waste Management Inc., noting that that Andersen repeatedly issued unqualified audits reports of the company. The SEC alleged that the audit firm agreed to conceal past accountings frauds committed by Waste Management if Waste Management agreed to make accounting changes in the future.

Tyco chairman Dennis Kozlowski was charged with criminal enterprise and grand larceny concerning securities fraud and thefts committed through his position with Tyco. His actions allegedly involved the procurement of unauthorized "sweet-heart" loans from various accounts at Tyco, and concealing the transactions from board members by ordering the internal auditors to report their findings directly to him.

Several members of WorldCom upper management were charged with securities fraud after multiple accusations of accounting irregularities

surfaced, including carrying over approximately \$5 million in expenses from one operating year to the next. There were allegations of collusion between WorldCom management and external stock analysts who continued to recommend World Com stock as more and more accounting irregularities surfaced.

Additionally, it was alleged that one such analyst advised WorldCom management beforehand of questions he would ask during financial conference calls. Chief Executive Officer Dennis Ebberts allegedly obtained \$408 million in loans from the company, contrary to accepted practices. WorldCom stock closed in 2002 at 35 cents after reaching \$90 in 1999. Review of the auditing procedures at the company revealed that the internal audit department was looking for inefficiency in operations and not reviewing accounting procedures.

Several members of the Rivas family, the founders and operators of Adelphia Communications were indicted for securities fraud at their company. According to SEC records \$3.1 billion was hidden through off-balance-sheet loans, and the debts were allegedly concealed from other board members.

## SEE ALSO

Arthur Andersen; stock fraud; stock churning; accounting fraud; Tyco International; WorldCom; Enron Corporation; Securities and Exchange Commission.

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## self-control theory

THE PRESUMPTION THAT virtually everyone in society is capable of illegal or criminal and other



deviant behavior because people are clever enough to see their advantages, is the basis of self-control theory. People have no trouble inventing wrongful behaviors and then discovering the easiest ways to commit them, with no special motivation or learning required for their completion. Why, then, is not everyone a criminal? Michael Gottfredson and Travis Hirschi's self-control theory, found in their *A General Theory of Crime*, stresses the importance of studying the factors that cause most individuals generally to obey the law, factors that center on a fear of the consequences for bad behavior.

Virtually all crimes promise to net the perpetrator some expression of immediate self-gratification, be it money without work, sex without courtship, revenge without court delays, or simply excitement itself. It follows that persons likeliest to commit crime are those who are most unable to self-control pursuit of these outcomes. An individual's general level of self-control varies from very high (or little tendency for short-term gratification) to very low (great tendency for short-term gratification), and all of us fall somewhere within those extremes.

## CRIME SIMILARITY

Self-control theory's approach represents three major departures from other criminological postulations. Most fundamentally, because virtually all criminal acts promise the same thing—relatively immediate gratification—self-control theorists believe that distinctions such as white-collar and corporate crime or even violent and property crime have little utility, and, in fact obscure the similarity among criminal acts and among criminals. To illustrate this similarity, all of the following are looking for money (or its equivalent) based on the least amount of honest work: robbers, corporate polluters, shoplifters, bank embezzlers, doctors who perform unnecessary surgery, lawyers who over-bill, burglars, and price-fixers. Self-control theory therefore supposes that all of these offenders should be viewed as essentially the same.

A second important divergence of self-control theory is that it considers the division between criminal and noncriminal behavior to be a false distinction for theoretical purpose, because both crime and noncriminal deviant acts reveal manifestations of the same trait. Tobacco and alcohol use, lying, low academic performance and cheating, adultery, high debt, checkered work histories, unsafe sex, car

accidents from risky driving, gambling, and a host of other noncriminal behaviors will occur at rates based on how low one's self-control is, as will larceny, assault, embezzlement, rape, fraud, and murder. By transcending legalistic designations of which behaviors and individuals are criminal, self-control theory avoids many of the entanglements associated with figuring out such designations, and is able instead to concentrate on overall behavior patterns. Many of these noncriminal acts of self-gratification can contribute to financial and other stresses for an individual, increasing further the motivations and frustrations that lead a person to commit property crime, violent crime, and to use drugs. Indeed, extremely low self-control ravages a person's life far beyond the pains associated with official punishments, and official punishments are often the least of such persons' daily worries. However, self-control theory does not believe that involvement in one form of deviance leads to involvement in other forms. Rather, high involvement in both criminal and noncriminal deviant behaviors are caused by the same thing—lower self-control.

Third, the vast majority of popular criminological perspectives presume that something bad must happen to make someone a criminal. A person must be taught how to commit crime, or inherit bad genes, or be pressured by a bad economic situation. In a significant departure from this supposition, self-control theory believes that all people are born with innate tendencies to gratify themselves, and will act out those impulses unless something is done to help them control themselves. Parenting is seen as the major source for teaching self-control, through emphasizing respect for the feelings and rights of others and reinforcing the belief that society's rules are legitimate. Good parental teachings, regardless of who inculcates them, encourage people to delay immediate gratifications, most notably through child discipline and forming attachments to the parents.

## ASPECTS AND SYMPTOMS

Symptoms associated with low self-control are: risk-taking, or a quest for exciting and dangerous behavior; simplicity, or an avoidance of difficult tasks; low frustration tolerance, which is manifested in both having a temper and easy boredom; physicality, or a preference for physical rather than mental activity; impulsiveness, which involves more

concern with here-and-now pleasures than future outcomes; and self-centeredness, or looking out for oneself first and tending to blame oneself last. People who strongly exhibit these symptoms are, according to Gottfredson and Hirschi, “relatively unable or unwilling to delay gratification; they are relatively indifferent to punishment and to the interests of others.” However, even those with the lowest control do not commit crimes under all circumstances. And those with the highest control are not infallible, but will commit crime at an extremely low rate.

Self-control theory does not attempt to explain those relatively few criminal acts which do not involve immediate gratification. Mercy killing by physicians is a crime, but it is not based on the self-gratification of the offender, so it would be outside the purview of the theory. The same would be true for any illegal behaviors that are committed because of a higher principle rather than gaining some personal advantage. Thus, self-control theory is an atypical general theory of crime in that it explains some noncriminal behavior while at the same time does not attempt to explain some criminal behavior.

Self-control has an invariant and curvilinear life-course relationship with a person’s age. Self-control is at its lowest in every person’s life—regardless of where that person’s general level of self-control may be—from early adolescence through about age 30, and then slowly rises into later years. Self-control is stable—from early adolescence onward, people do not change their levels of self-control relative to others their age. People with lower levels of self-control will exploit a variety of opportunities, people, and animals to satisfy their self-gratification.

Opportunity is assumed to be ubiquitous—people are limited only by the opportunities with which they are confronted and that they invent. Deterrence is a strong component in self-control theory in that most normal people are able to take inventory of what they have to lose for committing the crime. They will also have some idea, correct or not, about what their probability of apprehension will be. We would expect crime to occur when the tendency for short-term gratification is coupled with both physical opportunity and a perception on the part of the potential offender that he is immune from at least immediate formal and nonformal sanctions. The absence of any one of these three conditions nullifies the theory’s prediction that crime is

very likely to occur. Making criminal opportunity physically more difficult (such as by installing locks or increasing the scrutiny in account audits), known as “target hardening,” is likely to fend off low self-control offenders because overcoming such barriers may be seen as involving too much effort since such persons are easily frustrated and avoid difficult tasks.

## MORE TO LOSE

As noted, the theory dismisses the notion that white-collar and corporate crime are meaningful groupings. However, Gottfredson and Hirschi do predict that the rate of occupational and other offenses by persons toward the high end of the occupational structure will be lower than that by persons toward the low end of the occupational structure, because selection processes inherent to the high end tend to recruit people with relatively higher self-control. As one goes higher in the occupational structure, one is also more likely to find persons who have reached long-term goals because of their greater self-control.

These in-hand achievements (such as an education, a career, a nice home, a respectable reputation within and outside of one’s family) are held dearly, and such persons therefore are less likely to commit crime because they have more to lose by doing so. They perceive much greater negative consequences for their criminal behavior than people situated much lower on the occupational ladder, and therefore would be more likely to be deterred. Lower self-control individuals, on the other hand, have very little to lose, and therefore are less responsive to sanction threats of all kinds.

To support self-control theory, research must account for age and demonstrate that people exhibit versatility and stability in their immediate gratification behaviors (both criminal and noncriminal) that vary inversely with measures of their self-control. The theory would predict that doctors who purposely perform unnecessary surgery also would be more likely to be involved in other medical crimes. Police who commit brutality should prove more likely to take bribes and have patrol car accidents. And corporate executives who cheat on their wives should be more likely also to cheat on their taxes.

The theory rejects the general notion of differential association that non-corrupt business people and women become corrupted later in life by the

corporate culture. Although self-control theory readily acknowledges that organizational structures and processes can either encourage or discourage the commission of offenses, it would nevertheless assert that levels of self-control can predict criminal rates in organizations better than criminogenic organizational environments can predict them. This would be true both for crime benefiting an organization and for crime against it. Such studies have yet to be done.

In addition to transcending the entanglements of theories that depend on the legalisms of criminal and noncriminal behavior, self-control theory's main contribution lies in having found the middle ground between two of criminology's most timeless findings—deterrence and early socialization.

#### SEE ALSO

differential association; conflict theory; critical theory; employee crimes.

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## Sentencing Guidelines

THROUGHOUT THE 1970s, a great deal of attention was focused on disparities in sentencing—people who committed the same crime rarely received the same sentence. This disparity also produced many cases in which persons received very little punishment for serious crimes. The response to fed-

eral sentencing disparity was the Sentencing Reform Act of 1984 (Title II of the Comprehensive Crime Control Act of 1984), which established the U.S. Sentencing Commission. Congress's objective was to enhance the ability of the federal criminal justice system to combat crime through an effective and fair sentencing system. Congress wanted honesty in sentencing so that potential offenders know the punishments that they were likely to receive. Congress also wanted uniformity in sentencing to promote fairness. The U.S. Sentencing Commission was established to review the existing practices of the federal law enforcement system and to create the Guidelines that were relatively concrete and equitable—the U.S. Sentencing Guidelines ("Guidelines"). The Guidelines have not only resulted in more equitable punishments for like offenders, they have also punished more severely many white collar criminals and corporations who otherwise would have escaped such sanctioning.

There are two sets of Guidelines, one for individuals (effective October 1, 1987) and one for organizations (effective November 1, 1991). Both individuals and organizations are separately punishable for crimes committed by persons working on behalf of an organization, and when the organization is owned by the offender(s), considerations are made to reduce the organizational punishment in light of the punishment given to the individual(s).

### PUNISHMENT OF INDIVIDUALS

Two factors determine an individual's sentence length: the offense level (ranging from a low of 1 to a high of 43) and the person's criminal history score. The offense level is generally based upon the harmfulness of the offense (bodily injury, monetary loss, property damage, and any other resulting harm) and the blame attributable to the offender for the crime in question. Dominant offense roles are more punishable than peripheral ones and negligent behavior is less punishable than willful behavior, for instance. The criminal history score is generally based upon the extent and recentness of one's officially documented criminal past.

If the individual has a long-standing previous criminal record, the incarceration length and amount of fine are increased substantially. Such enhancements were justified by the Commission on the grounds that repeat offenders are more blameworthy when they commit subsequent offenses and

that increased punishments are needed to deter them from future illegalities and to isolate them from society for longer periods.

The Guidelines for individuals work as follows. Most felonies and Class A misdemeanors in the several volumes of the United States Code have been assigned an offense level, although many regulatory violations are not included. However, price fixing, money laundering, mishandling of toxic substances, mail and wire fraud, bribery, and a host of other crimes that are committed for the benefit of an organization are punishable under the Guidelines for individuals. Depending upon explicitly defined aggravating and mitigating factors, the level can be increased or decreased, respectively.

### AGGRAVATING FACTORS

The greatest monetary value associated with the crime (amount stolen or bribed, criminal profit to the offender, loss to the victim), the vulnerability of the victim, and the offender's role in the offense are some of the factors that will increase or decrease the base offense level. The extent to which the offense endangered public welfare (national security, public health or safety) would enhance the level of the offense. Whether the offender abused a position of trust or special skill in the commission of the offense is also an aggravating factor.

Cooperation by the defendant will lessen the sentence slightly, but a guilty plea is not supposed to be treated as a demonstration of cooperation. Both *no lo contendre* pleas ("I neither admit nor deny the charges") and Alford pleas ("I do not admit the offense but acknowledge that there is enough evidence to convict me") are considered to be guilty pleas by the Guidelines. The final offense level is then located on a row in the Sentencing Table (in Guidelines, Chapter 5). The final incarceration range is determined by the offender's criminal history score in that row.

Offense levels, but not criminal history scores, equate also with monetary penalties for a given offense or set of offenses—a fine up to \$250,000 (or more if allowed by statute; found in Guidelines Chapter 5), victim restitution, prosecution costs, and in some cases, forfeiture of assets related to criminal behavior. Restitution is the pre-eminent concern. The U.S. District Court judge then sentences to any incarceration and monetary penalties within the ranges allowed. The U.S. District Court

"shall" impose a fine within the specified range, but can reduce or eliminate the fine if the offender is unable to pay it and is unlikely to be able to pay it sometime in the future. The adverse effects of a fine on a defendant's dependents are also a consideration. The Guidelines expressly prohibit a reduction in sentence based on any "lack of guidance" the defendant experienced as a youth. Probation for individuals is allowed only when the offense level is very low.

Two offenses may be vastly different in terms of harm and culpability, even though they violate the same statute. To help ensure that the penalty is proportional to the offense, the Guidelines attempt to punish on the basis of "real offense sentencing"—the actual conduct in which the offender engaged. Further, in sentencing for multiple crimes, the cumulative harm associated with the "same course of conduct" or a "common scheme or plan" is used in the determination of offense levels. A "common scheme or plan" involves common victims, common accomplices, a common purpose, or a similar modus operandi. Multiple offending which may not qualify as a common scheme or plan may nevertheless be considered to be part of a "same course of conduct" when a spree or series of ongoing offenses can be viewed as similar and occurring at relatively short time intervals.

### PUNISHMENT OF ORGANIZATIONS

Chapter 8 of the Guidelines covers organizations, and it is also based upon real offense sentencing. "Organizations" include any legal entity other than an individual: corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations. As in the case of Guidelines for individuals, organizational penalties consider offense harm, organizational culpability, and previous organizational criminality in determining the monetary penalty that is to be paid by the organization. Historically, more than 90 percent of organizations sentenced under the Guidelines have been "closely held" organizations with a small number of owners. Less than 5 percent of organizations sentenced under the Guidelines are larger, publicly traded corporations. Research shows the majority of sentenced organizations, close to four-fifths, have fewer than 50 employees. About 1 in 10 is a recidivist.

The Guidelines punish organizations based on vicarious liability, or *respondeat superior*. Vicarious liability covers the illegal acts of any director, officer, employee, or independent contractor authorized to act on behalf of the organization. Offense levels for organizations are based essentially on the same criteria as individual offense levels, including aggravating and mitigating factors. Probation is also possible for organizations, especially when necessary to collect a fine or to restructure the organization to prevent future offenses.

The Chapter 8 fines for organizations have been enormous in a few select cases, having reached into several hundreds of millions of dollars. However, the vast majority of fines are associated with small organizations where the dollar values are consistently much less. Some larger organizations have avoided criminal prosecution under the Guidelines because they have the resources to leverage prosecutors into accepting civil and administrative sanctions. Or, they have circumvented vicarious liability by redirecting blame to their employees based on the leeway of the Guidelines.

### ORGANIZATIONAL FINING PROCEDURES

Generally, the Guidelines provide that some combination of the following be paid by convicted organizational offenders: 1) victim restitution and any other costs that would be associated with righting the harm of the offense (restitution is paramount); 2) a fine; 3) payment (or “disgorgement”) of any criminal profits beyond the value of restitution that has been or will be paid, including any social losses (such as harm to a marketplace in an antitrust crime); and 4) costs of prosecution. The disgorgement of profits realized from the offense must be added to the fine, so the monetary penalty will always exceed the financial benefits of organizational criminal behavior. In addition, organizations can be sentenced to community service (which can involve expenditures) and they may be forced to make expensive structural changes designed to preclude future offending.

If an organization cannot pay its proper fine either because it has no assets or because paying the fine will jeopardize full payment of victim restitution, the court can waive the fine entirely (under Guidelines §8C3.3). Research has shown that two-thirds of convicted organizations that cannot pay receive no fine whatsoever; if they do receive a fine,

it is substantially less than the prescribed minimum. Organizations are allowed up to five years to pay their fines.

### FINE RANGES

Determining the fine range for organizations is much more complicated than determining it for individuals. First, a base fine must be decided, and it is the greatest of the following: the fine associated with a specific offense level (found in Chapter 8), pecuniary gain (pre-tax profit from the offense), or financial harm to victim(s). Base fines are high because they need to demonstrate the seriousness of the offense and that the fine is punitive, and they need to act as just punishment and as a deterrent to the organization (and to others). In no case can a fine be more than is allowed by statute. Currently, base fines cover an array from \$5,000 (for an offense level of 6 or less) to \$72.5 million (for an offense level of 38 or more). Actual fine ranges are determined by a “culpability score” and each score has a specific minimum and maximum multiplier that is applied to the base fine in order to determine the fine range in which the sentence will fall. The score begins at five and can be reduced to as low as zero or increased to as high as ten.

The culpability score will be increased if the organization’s management either “participated in,” “condoned,” or was “willfully ignorant” of the offense. The amount of the increase for this provision is based on the size of the organization, ranging from 1 point (10-49 employees) to 5 points (5,000 or more employees). The larger the organization, the higher the government’s expectation that management create formal structures to eliminate the organization’s participation in illegality.

Criminal history is also an aggravator, adding one point if a similar offense had occurred within the past 10 years, and two points if it had occurred within the past five. If the crime involves a violation of a previous court order or condition of probation, one or two points are added, depending on the situation. If the organization in any way obstructed justice related to the investigation or prosecution of the offense, including failure to prevent obstruction, 3 points are added.

Reductions in the culpability score are based on the following: 1) the organization had an effective compliance program to detect, prevent, and report violations at the time of the offense (subtract 3

points); and 2) the organization brought the offense to the attention of appropriate government officials before outside discovery was imminent, it accepted responsibility for the offense, and it fully cooperated with authorities in the investigation of the offense (subtract 5 points). Cooperation and acceptance entitles the organization to a 2-point reduction, and acceptance of responsibility alone entitles it to a 1-point reduction.

The culpability score, in essence, punishes according to the inverse of the probability that an offense will be officially detected. Higher probabilities of detection—based on compliance programs, reporting the offense to the authorities, and cooperating in investigations—equate with lower culpability. Lower probabilities of detection—when management participates in, condones, or is willfully ignorant of the offending, or there is obstruction of justice—equate with higher culpability.

Minimum multipliers for the base fine vary from .05 (culpability score  $\geq 0$ ) to 2.0 (culpability score  $\geq 10$ ). Maximum multipliers vary from 0.2 (culpability score  $\geq 0$ ) to 4.0 (culpability score  $\geq 10$ ). The presumptive culpability score of five equates to multipliers of 1.0 and 2.0. As an example, if an organization's base fine is \$10,000 and the culpability score remains at the presumptive five, the fine range would be \$10,000 to \$20,000 (based on its minimum and maximum multipliers). If its culpability score is 0 or less, the fine range is \$500 to \$1,000, and it is \$20,000 to \$40,000 if the culpability score is 10 or more. Thus, based on the culpability score, a fine can vary by as much as a factor of eighty (.05 to 4.0). Organizations will be fined within the prescribed range according to various criteria, including victim vulnerability or psychological harm, the role of the organization in the offense, and whether there is recidivism associated with the current offense(s). Any monies paid previously in civil or criminal proceedings because of the offense should be deducted from the fine.

The determination of the culpability score becomes especially important with the highest base fines. Before the Guidelines were put forth, there was a strong and quite reasonable concern about the lessening in culpability scores related to the 3-point reduction for the existence of a compliance program to detect, prevent, and report violations. It was believed that devious corporations would construct merely cosmetic façades for such programs, and then redirect risks of vicarious liability onto

their employees, thereby reaping both the benefits of crime and the benefits of reductions in culpability. The U.S. Sentencing Commission was very sensitive to this possibility, and put forth explicit criteria about what constitutes an effective compliance program that would qualify under the Guidelines. Even with these well defined criteria for compliance, the commission's earliest fears about the misuse of this culpability mitigation have not proved to be unfounded.

## COMPLIANCE PROGRAMS

The U.S. Sentencing Commission equates the requirements for compliance programming with being a "good corporate citizen." The criteria for qualifying compliance programs have come to be known as the "Seven Steps," and the government hallmark is whether the organization used "due diligence" to prevent, detect, and report legal violations. The Guidelines assert that the failure to prevent or detect an offense will not, by itself, render a compliance program ineffective. However, the Guidelines also imply that the only real way to measure whether a program was designed, implemented, and enforced with due diligence is in the scarcity of violations.

The "Seven Steps" involve: 1) the establishment of compliance standards and procedures; 2) the designation of high-level personnel as having responsibility to oversee the program; 3) the avoidance of delegating authority to persons known to have a propensity to engage in illegalities; 4) taking steps to communicate effectively the standards and procedures; 5) the establishment of monitoring and auditing systems to detect violations and of a reporting system by which employees can report criminal conduct of others within the organization without fear of reprisal; 6) consistent enforcement of standards through disciplinary mechanisms, including the discipline of individuals responsible for overseeing compliance structures when there is a failure to detect an offense; and 7) the organization taking all reasonable steps to respond appropriately to an offense that has occurred and to prevent further similar offenses, including any necessary modifications to its program.

The Guidelines further emphasize that the larger an organization, the more stringent the expectations for effective compliance programming. Organizations must also anticipate violations that are

known or probable based on their organizational history and their sector or industry, and design their programs accordingly. Further, an organization's failure to follow industry practice or a legal regulation is contrary to a finding that its program was effective.

Despite the importance the Guidelines places on effective compliance, research for the U.S. Sentencing Commission has found that most employees working in very large corporations believe that the Guidelines have had a limited, insignificant, or negative effect on compliance efforts. Commission research has also concluded that the two most important environmental factors in an organization contributing to noncompliance are remuneration incentives for unethical behavior and employees' perceived threats of reprisal for reporting violations.

### ORGANIZATIONAL PROBATION

Before its codification in the Guidelines, organizational probation was used for the first time in a federal criminal case in 1971 in *United States v. Atlantic Richfield Co.* (465 F.2d 58). U.S. District Court Judge James B. Parsons, Jr. broke jurisprudential ground by placing ARCO on probation so that he could monitor the company's progress in complying with his order to develop an oil spill response program. Parsons's innovation was widely copied by his colleagues, and by the middle 1980s, probation was ordered in approximately a fifth of all federal corporate convictions. However, many of these probation orders were successfully appealed because, although probation for individuals had been well entrenched in the federal law for 60 years, there were no legal provisions to justify this type of sentence for organizations, until the Guidelines §8D1.1.

Under the Guidelines, a convicted organization can be placed on probation for between one and five years to ensure that it will pay its fine and that it will rehabilitate its compliance structure to help prevent future violations. Such rehabilitation includes submitting to the court a viable compliance program, including a schedule for implementation. To monitor whether the organization is following the program, the organization must submit to regular audits and interrogations of key individuals by outsiders, the costs of which will be paid by the organization. The organization will also be required to notify its employees and shareholders of its crimi-

nal behavior and of its new compliance structure. Any failure to follow these or other conditions of probation will result in the revocation of probation and resentencing to more punitive sanctions. Early research indicates that about two-thirds of organizations convicted under the Guidelines are placed on probation, about one in five of which were also ordered to create a compliance program. Organizations of all sizes have been placed on probation under the Guidelines.

One of the most interesting features of organizational probation under the Guidelines is the possibility for court-imposed adverse publicity. The court can, as a condition of probation, order the convicted organization to publicize the nature of the offense committed, the fact of conviction, the nature of the punishment imposed, and the steps that will be taken to prevent the occurrence of similar offenses. There is a befitting poetic justice in the fact that the organization will have to pay for its own adverse publicity. Forced adverse publicity penalties are analogous to a "corporate pillory," for they place organizational offenders at public ridicule. The primary purposes of this sanction is shaming the organization and as a deterrent, but it is seldom imposed.

In conclusion, in order for the Guidelines to act as its intended deterrent, decision makers in large corporations must perceive a high probability of being implicated in and convicted for organizational criminal behavior. To help encourage this perception, federal prosecutors must be willing to spend their resources pursuing rich corporations in protracted criminal court battles, and they should not acquiesce to negotiations for a civil settlement in *prima facie* criminal cases.

Experts agree that prosecutors should also be critical in their acceptance of corporate assertions that lower level employees are responsible for offending when there is an "effective compliance program" in place to detect, prevent, and report violations. For persons making decisions in small and powerless organizations (the vast majority sentenced under the Guidelines) the deterrent value of fine threats will work only to the point that the potential offender is able to pay. Threats beyond that capability offer no additional deterrent.

### SEE ALSO

reform and regulation; prosecution; corporate liability; consent decrees and orders; compliance programs.

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## sexual discrimination

SEE gender discrimination.

## sexual harassment

SEXUAL HARASSMENT is unwanted sexual behavior that interferes with occupational or educational functioning and is a form of white-collar crime. However, there is no statutory law criminalizing sexual harassment, but court cases against harassers in civil court have been won based upon Title VII of the 1964 Civil Rights Act prohibiting sex discrimination.

The term *sexual harassment* was coined in 1970 when Carmita Wood, an administrative assistant at Cornell University sued the university for unemployment compensation after she left the university due to an illness, precipitated as the result of ongoing sexual advances from a university professor. In 1972, Congress passed the Equal Opportunity Em-

ployment Act extending the coverage of Title VII to state and local governments and empowering the Equal Employment Opportunity Commission to enforce, via lawsuits, the 1964 prohibition on sex and race discrimination in employment.

In 1980, the chair of the Equal Employment Opportunity Commission issued a set of guidelines detailing prohibited behavior that applied to all federal agencies and to private businesses with 15 or more employees. The guidelines included the prohibition of three general types of behaviors: 1) physical or verbal behaviors that are sexual in nature, including comments, photographs, jokes, or cartoons; 2) unwanted sexual behaviors; and 3) sexual behaviors that interfere with the ability to complete work or studies or that make the subject feel uncomfortable or threatened.

Generally sexual harassment is characterized by two types, *quid pro quo* harassment, and the creation of a hostile work or educational environment. *Quid pro quo* harassment occurs when an employee's initial or continued employment or advancement is conditioned on the performance of sexual favors. A hostile environment is the result of unwelcome or offensive conduct of a sexual nature that makes working conditions uncomfortable for a reasonable person.

Specifically, a hostile work environment charge of sexual harassment may consist of verbal or physical conduct of a sexual nature that unreasonably interferes with the employee's work, or creates an intimidating, hostile, or offensive work environment. Sexual harassment has been shown to lead to high rates of job turnover, lower productivity, and negative health consequences.

Sexual harassment in federal agencies alone costs the government approximately \$327 million from 1992 to 1994. In 1994, 44 percent of women and 19 percent of men employed in civilian federal government agencies reported experiencing unwanted sexual attention over the last two years. While in a 1994–95 survey of military personnel, 71 percent of women and 36 percent of men were sexually harassed in the last 12 months. Crude and offensive behavior is most common among military personnel, but women are five times as likely as men to report experiencing unwanted sexual attention or coercion.

Twelve percent of military women report experiencing sexual coercion, and 41 percent reported unwanted sexual attention. Similarly, surveys in the



private sector reveal that 45 to 68 percent of women experienced sexual harassment over a two-year period.

## CASE STUDIES

In order to bring a successful lawsuit, the harassment needs to be pervasive, frequent, repetitive, and a part of an overall environmental pattern of behavior. In 1976, the U.S. District Court for New Jersey recognized a cause for sexual harassment in *Tompkins v. Public Services Electric and Gas Company*. Also in 1976, the first *quid pro quo* sexual harassment case was decided in *Williams v. Saxbe*. In this case, Diane Williams was fired from the Department of Justice after refusing sexual advances from a supervisor. Federal judges established sexual harassment as a cause for sex-based discrimination civil suits making employers liable (413 F. Supp. 654 D.D.C. 1976).

In 1981, the first successful lawsuit arguing hostile environment was *Bundy v. Jackson* in which Sandra Bundy was harassed by a barrage of sexual insults and propositions leading to anxiety and debilitation. In 1985, in *Hicks v. Gates Rubber Company* and *McKinney v. Dole*, the court stated that sex-based harassment (not incorporating sexual language or activity) can violate Title VII if it is "sufficiently patterned or pervasive" and targeted toward an employee because of his sex.

In 1986, *Meritor Savings Bank v. Vinson* (U.S. 57), the U.S. Supreme Court held that willful submission to sexual conduct does not suppress a claim of sexual harassment and that such harassment is a form of sex discrimination. The court also stated that *quid pro quo* and hostile environment violated Title VII of the Civil Rights Act. These legal precedents prohibit employment discrimination based on race, color, national origin, religion, or sex in any educational program or activity that receives federal funds and by all private employers.

Sexual harassment is also cause of action based upon Title IX of the Education Amendments of 1972 and under the Equal Protection Clause of the Fourteenth Amendment. In 1992, in *Franklin v. Gwinnett County Public Schools*, the Supreme Court found that Title IX of the Educational Amendments of 1972 had been violated due to the sexual harassment of several students by teachers and inaction by the school administration. One student, Christine Franklin, was forcibly kissed by a teacher and subjected to sexually oriented conversation.

Subsequently, the school principal was told about the harassment. But the principal discouraged Franklin from making a complaint even though several other students had made similar complaints. The court stated that this behavior by a teacher and the inaction by the principal was a form of gender discrimination.

However, in another court case in 1993, the Supreme Court found that an initial warning to a teacher for inappropriate sexual remarks to students and a later dismissal after rape charges were filed were sufficient corrective measures and did not classify as a violation of student rights under Title IX (*Gebser v. Lago Vista Independent School District*). Finally, in 1999 in *Davis v. Monroe County Board of Education*, a student was subjected to sexual remarks and sexual touching by a male classmate and reported it. However, school officials failed to act on reports and thus were found liable since they received federal assistance, and were deliberately indifferent to depriving the victim of educational opportunities and benefits provided by the school.

## HARASSMENT AT WORK

Several lower federal court decisions are also important in understanding sexual harassment at work. Employers are not liable if they establish and implement preventative policies on sexual harassment, take prompt action to remedy the harassment situation, or when the victim knew or should have known that the employer did not tolerate sexual harassment. Another court case (*Lipsett v. University of Puerto Rico* 864 F.2d 881) also ruled that conduct that men consider unobjectionable may offend many women. Similarly, in 1987, (*Barbetta v. Chemlawn Services Corporation*) the court found that the "proliferation of pornography may be found to create an atmosphere where women are viewed as men's sexual playthings rather than their equal coworkers if it is sufficiently continuous and pervasive."

Also in *Berkman v. City of New York* (775 F.2d. 913) the court decided that harassing conduct of a non-sexual nature could also constitute sexual harassment if the environment is hostile to women in other ways. Other causes of action include workplace behavior that includes gossip about workplace affairs, use of unwelcome foul language, or sexual innuendo. In 1998 (*Burlington Industries Inc. v. Ellerth*

and *Faragher v. City of Boca Raton*), the courts decided that employers are subject to vicarious liability for a victimized company employee in hostile environment cases.

A federal circuit court determined that lower level (*Parkins v. Civil Constructors of Illinois Inc.*) employees are subject to negligent charges rather than vicarious liability. Finally, in 1998, a federal regulation established guidelines for workplace conduct that are actionable for a civil tort under Title VII and these include "unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature." However, substantive law or statutes as well as case law (court cases) require that, while the employer must demonstrate that she made reasonable efforts to prevent and correct such harassment, the employee or victim or plaintiff must also show that he made an effort to avoid or prevent harm from the harassment. Employers who subsequently discharge, demote, or reassign the victim also make the employer liable for the harassment.

In a 1999 case, the New Jersey Supreme Court (*Blakely v. Continental Airlines*) ruled that sexual harassment and other types of sex discrimination that occur on the internet outside the workplace, but connected to the workplace, still make the company liable under sex discrimination statutes. In this case, a commercial airline pilot, Tammy Blakely, was sexually harassed at work through the placement of pornography in her cockpit as well as a variety of verbal comments. This was followed by further retaliatory behavior by her male coworkers on the company's internet bulletin board site.

With regard to the internet, the court ruled that employers must remedy any retaliatory harassment even in cyberspace. Finally, in 2002, the Ninth Circuit Court of Appeals ruled in favor of an openly gay male who was sexually harassed by his male coworkers by whistling, blowing kisses, telling crude jokes, and forcing him to look at pictures of men having sex. Six out of 10 judges ruled that the behavior was actionable under Title VII, first under physical sexual assault provisions, and secondly under gender stereotyping theory that recognizes that same sex harassment is actionable.

## HARASSMENT REPORTING

Research indicates that there exists a gross under-reporting of sexual discrimination and harassment,

but the experience of sexual harassment remains quite common among women, with most offenders being men. Women's responses to harassment and discrimination are varied. About half of all women will likely experience sexual harassment at work from male coworkers, supervisors, clients, or customers while about 30 to 66 percent of female students can expect to be harassed by teachers, administrators, staff, or peers. Anywhere from 44 to 85 percent of U.S. women and 78 percent of Canadian women are sexually harassed, whereas only 12 to 19 percent of U.S. men experience sexual harassment.

Similarly, there is some evidence that women who occupy non-traditional roles at work may more likely to be sexually harassed than women in more traditional workplace positions. Studies also reveal that less than 12 percent of women actually file complaints, and only about 24 percent ever even disclose the event. Additionally, less than 1 percent of sexual harassment claims are heard in court and only about one third of these outcomes favor the victim.

Costs of sexual harassment among federal employees have been estimated as high as \$300 million, and among Fortune 500 companies it has cost more than \$6 million in productivity. Feminists argue that sexual harassment by men reflects the patriarchal nature of the workplace characterized by an environment where men have more economic and institutional power, and thus engage in behavior that attempts to further subordinate and disempower women. However, it should be noted that men in female dominated positions are also more likely to experience sexual harassment than other men. The Federal Equal Employment Opportunity Commission's annual report indicates that the filing of formal complaints by victims remains very limited. Specifically, in 1999, only 23,907 complaints were filed under Title VII alleging sex-based discrimination; similarly 15,222 sexual harassment complaints were filed in 1999 (12 percent of the charges were filed by men).

However, only 7 percent of the sexual harassment cases resulted in findings of reasonable cause; 2 percent were successfully conciliated; 7 percent were withdrawn with benefits; and 23 percent resulted in a merit resolution. In regard to the sex discrimination filings, only 6 percent of the cases resulted in findings of reasonable cause; 2 percent were successfully conciliated; 4 percent were

withdrawn with benefits; and 17 percent resulted in a merit resolution.

## PREDICTORS AND EFFECTS

The best predictors of harassment are the gender composition of the work place, that is, a male-dominated workplace with men holding supervisory positions and women occupying less powerful roles. However, there is some evidence that when gender roles are reversed sexual harassment is also likely to occur. But today, generally, victims are more likely to be female, unmarried, to have some college and to be supervised by men.

Women with lower level positions in the workplace and less college education are more likely to be sexually harassed. Men who are harassed are more likely to be harassed by coworkers, whereas women are more likely to be harassed by supervisors. Empirical evidence reveals that women who work in male-dominated workplaces or in traditional male jobs are more likely to be harassed than women in other types of jobs, as are white and minority women who work in particularly low level positions. However, recent research reveals that about 1 percent of females are also harassed by other women while 35 percent of men are harassed by women. Recently in *Papa v. Domino's Pizza*, the first EEOC trial in which a male employee won \$237,000, the case was won after proving that his female supervisor sexually harassed him.

Research indicates that many women victims of harassment often simply change jobs. Women who do file complaints often report experiencing counterclaims and in fighting against such claims are often re-victimized. This retaliation, combined with the fact that women tend to avoid risk-taking, makes it understandable that women are reluctant to file formal complaints of sex discrimination or sexual harassment. In fact, reporting or filing a sexual harassment or sexual discrimination complaint may be the least likely response of most women. Some evidence indicates that women who report are more likely to have experienced extremely offensive sexual harassment and that these women are less likely to perceive disadvantages to reporting, and are more likely to be white and to have access to more workplace power.

Moreover, the effects of harassment on the victim include harming both physical and mental well-being, as well as increasing feelings of helplessness

and lowered self-esteem. Students who are harassed often have lower grades and may avoid certain classes in order to avoid the perpetrator.

In 1996, the Equal Opportunity Employment Commission sued Mitsubishi Motor Corporation's American Division on behalf of more than 400 women who reported that the company had allowed the creation and maintenance of a hostile work environment. These incidents included pervasive physical groping of female workers by male coworkers and sexual graffiti scrawled on bathroom walls.

Dial Soap Company also settled a class action sexual harassment lawsuit. In this situation, 100 women reported that sexual harassment had been a part of their daily experience in an Aurora, Illinois, factory for over 10 years. Dial agreed to pay \$10 million and to comply with 30 months of independent monitoring. The EEOC reported that its investigation revealed that women at Dial experienced all types of sexual harassment and described the Aurora plant as free-for-all with regard to the degree and quantity of harassment. Similarly, 14 women at a Ford plant in Chicago, Illinois, also settled a \$7.5 million sexual harassment case that was later increased to \$9 million in a district court review. The women reported being verbally harassed with cat-calls, swearing, and suggestive language while working on the assembly line.

Sexual harassment is a form of white-collar crime that is being treated more seriously by the civil court system. However, sexual harassment remains a pervasive problem in the workplace.

## SEE ALSO

gender discrimination; racial discrimination.

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## Sherman Antitrust Act

THE SHERMAN Antitrust Act of 1890 provided the first, and what remains the most important legal basis for efforts to break up exploitative monopolies and commercial behaviors, such as price-fixing agreements, that produce concentrations of economic power. The act was sponsored by Senator John Sherman (1823–1900) of Ohio, who had declared: “If we will not endure a king as a political power, we should not endure a king over the production, transportation, and sale of any of the necessities of life.” The Sherman Act, as Lawrence Friedman has noted, was surprisingly brief: less than two pages in length. The law is, Friedman observes, “terse,” “vague,” and “ambiguous.” Notably absent are definitions of such key terms as “monopoly” and “restraint of trade.”

The heart of the Sherman Act is Section 1 which reads: “Every contract, combination in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by a fine not exceeding \$5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.”

In 1914, Congress added the Clayton Act and the Federal Trade Commission Act to strengthen the Sherman Act. The Clayton Act specifically prohibited four practices: 1) price discrimination, that is, selling products more cheaply to a favored customer; 2) exclusive-dealing contracts, tying a pur-

chaser to deal exclusively with a single supplier and often on a long-term basis; 3) mergers that unduly restricted competition; and 4) interlocking directorates in which the same person sits on the boards of companies supposed to be in competition. Some agricultural combinations were exempted from the Clayton Act so that farmers’ cooperatives could retain their legal status.

The new laws were a response to the Supreme Court’s 1911 decision in *Standard Oil of New Jersey v. United States* (221 U.S. 1) which, though it favored the government’s position, opened up a number of loopholes in antitrust regulation. These new statutes extending the reach of the Sherman Act relied on administrative rather than criminal law to deal with unfair competition. The Federal Trade Commission, made up of five members, was established to help the Department of Justice to prevent unfair and deceptive practices.

Further amendments and additions followed, including the Robinson-Patman Act of 1936 which shored up the ban on price discrimination ban, and the Celler-Kefauver Act of 1950, which toughened anti-merger rules and prohibited the purchase of the plant, equipment, or assets of a competitor. In 1975, Congress changed violations of the Sherman Act from misdemeanors to felonies and raised the ceiling on fines significantly.

During the first decades of the Sherman Act, enforcement was virtually non-existent. This situation reinforced the view of those who believed that the law had been passed to calm public resentment while, at the same time, not interfering greatly with business-as-usual, since the politicians in Congress relied heavily upon the support of the corporate world for campaign contributions. The Department of Justice filed only nine cases during the first five years of the Sherman Act, and only 22 in the first 15 years. These early cases often resulted in verdicts favoring the accused.

In 1892, for example, a district judge dismissed an indictment against five lumber dealers alleged to have conspired to charge an additional 50 cents on 1,000 feet of pine in the five states where they marketed their product. The court held that such price-fixing was permissible unless it could be proven that the agreement had influenced all lumber dealers in the area to follow its example (*United States v. Nelson*, 52 Fed. 646. 1852).

Critics insisted that it was obvious that the lumber dealers had acted as they did because they knew

that their tactics would increase their profits. The following year, in 1893, a prosecution of the National Cash Register Company (NCR) also fizzled. James Henry Patterson, owner of NCR, had vanquished his competitors, occasionally buying them out, but more often employing predatory pricing tactics and nastily aggressive salesmanship to undercut them. Patterson had his salesforce seek to convince employers that they needed his cash registers in order to avoid tempting, and being ripped-off by employees. So effective were Patterson's methods that, in a later decade, one-fourth of all the chief executives of Fortune 500 companies had received their indoctrination into business at NCR.

Though he had driven out of business or gobbled up a significant portion of NCR's competition, a federal court found that the Sherman Act did not prohibit what Patterson had done. "It must appear somewhere in the indictment that there was a conspiracy in restraint of trade by . . . monopolizing the market, and it is not sufficient to allege a purpose to drive certain competitors out of the field by violence, annoyance, intimidation, or otherwise (*United States v. Patterson*, 55 Fed. 605, 641, 1893).

The Supreme Court was no less ready to strike down merger prosecutions. The facts in *United States v. E.C. Knight Co.* (156 U.S. 1, 1895) show that the American Sugar Refining Company was busily absorbing its remaining few competitors, four businesses in Pennsylvania that controlled 33 percent of the refinery business with the Revere company in Boston having 2 percent of the market. American Sugar had bought out the Pennsylvania group, which gave it 98 percent control of sugar refining in the United States. The Supreme Court decreed, however, that American Sugar was a monopoly of manufacture and not of interstate or international commerce and that only the latter was forbidden by the Sherman Act. "Commerce succeeds to manufacture and is not part of it," the court declared. The opinion in passing mentioned a doctrine that was to come to dominate thinking about monopolies nearly a century later. According to political economists, declared Chief Justice Melville Fuller, "aggregates of capital may reduce prices."

In an elegant dissent, Justice John Harlan offered a view not wrapped in legalistic hair-splitting but based on a commonsense understanding of what was required to control monopolies: "It will be cause for regret that the patriots who framed the

Constitution did not foresee the necessity of investing the national government with power to deal with gigantic monopolies holding in their grasp, and injuriously controlling in their own interest, the entire trade among the States in food products that are essential to every household in the land."

Not a single violator of the Sherman Antitrust Act went to jail until 1921, more than 30 years after the enactment of the law. During the first 50 years of the act, only 24 cases led to jail sentences out of 252 prosecutions. Eleven of these cases involved businessmen; the others were trade union leaders. Significantly, 10 of the 11 sentences of businessmen involved acts of violence, threats, or other forms of intimidation.

Matters changed dramatically as Franklin D. Roosevelt's presidency ushered in a period of vigorous antitrust enforcement. Many of the cases arose during World War II and were directed against companies headquartered in Germany, Italy, and the United States that supported America's wartime enemies.

The first prison sentence for price-fixing was imposed in the 1950s in a hand-tools industry case, though the case did not differ markedly from many that preceded it. Throughout the 1950s, however, antitrust enforcement tended to be inconsistent. But the heat on business clearly stepped up as time went by because of the combined influences, among other developments, of the Ralph Nader movement, the Watergate scandal, the rise of the counterculture, and the press reporting on those excluded from the mainstream for a fairer deal. From 1981 to 1985 there was, for the first time, a greater number of criminal than civil antitrust case filed in federal courts. Particularly notable in that period was the 1984 breakup of the American Telephone & Telegraph (AT&T) in a decision that forced AT&T to reshape itself as a long-distance company and create seven "Baby Bells."

This tough stance abated when economists, primarily from the University of Chicago, successfully pressed the argument that monopolies were not necessarily harmful. They based their position on the declaration in a 1920 Supreme Court ruling that illegal monopolies were to be judged in terms of whether they were "unreasonable." The economists maintained that the test ought to be framed in terms of the actual consequences of the control that a monopolistic entity exerted over the marketplace. The burden then fell on prosecutors to demonstrate

higher prices existed than those that would have prevailed under freer competitive circumstances, a task that often resulted in mind-numbing testimony by well-paid corporate expert witnesses whose fancy mathematical analyses were well beyond the reach of judges and jurors.

Some monopolies, the pro-business economists insisted, are beneficial because, among other things, they reduce operating costs. The courts listened, and the criminal prosecution of antitrust cases became a much more difficult enterprise than it had been when monopolization alone was regarded as illegal.

Recent antitrust charges against Microsoft represent one of the better-known invocations of the Sherman Act. The government claimed that Microsoft's overwhelming market share in the personal computer operating system market had given it an unfair advantage over competitors such as RealNetworks and American Online. Microsoft, it was said, had tried to monopolize the internet browser market by unlawfully tying its Internet Explorer software to its Windows operating system in order to exclude rival products by Netscape.

"Because of its monopoly Microsoft can skimp on quality," former Senator Howard Metzenbaum declared. "It ships products with avoidable defects, sells upgrades that often are of marginal value ... and it has repeatedly imitated the innovative leaders in the industry and then driven them out of the market."

A decision by district court judge Thomas Penfield Jackson called Microsoft "untrustworthy" and an "unrepentant lawbreaker." Jackson ruled that Microsoft had to be broken into two companies as a penalty for inhibiting consumer choices and breaking antitrust law. But an appeals court reversed the breakup order, and the case was assigned to another judge. This resulted in a settlement in which Microsoft agreed to disclose more technical information about its Windows operating system so that competitors can write programs that work with Microsoft equipment.

#### SEE ALSO

antitrust; Clayton Act; Federal Trade Commission; Microsoft; Robinson-Patman Act; Celler-Kefauver Act.

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## Short, James F., Jr. (1924–)

JAMES SHORT GREW up in a small Illinois town where his father was the principal of the rural community school that he attended for 12 years. During his formative years, Short's educational experiences instilled a deep sense of personal responsibility and respect for the virtues of learning. His strong work ethic developed at the age of six when he began toiling at odd jobs on nearby farms. Though thankful for the opportunities, Short quickly realized that he would seek an alternative area of expertise for his life's work.

After graduating from high school, he enrolled at Shurtleff College, a small Baptist institution, in Alton, Illinois. Short enlisted in the U.S. Marine Corps Reserve while attending college and in 1943 was sent to a training program at Denison University in Granville, Ohio, and then to Parris Island for boot camp in 1943. Short eventually became part of the occupying forces in Japan after the bombing of Hiroshima and Nagasaki. His return to the United States marked an illustrious and fruitful career in sociology and criminology.

Short's contributions on the sociology of risk and organizational theory have had a substantial impact on the study of white-collar crime. In the early 1980s, Short and Donna Randall's exploration of women working in a toxic environment inspired his interest and research in risk analysis studies and his presidential address to the American Sociological Association ("The Social Fabric at Risk: Toward the Social Transformation of Risk Analysis"). In 1991,

he joined a research team established to study the effects of a proposed nuclear waste facility in Nevada's Yucca Mountain. His research on risk analysis (a field that generally explores technical problems; for example, location of toxic waste disposal sites), refocused efforts to include the impact of technology on social constructs and public policy. Short notes that his "enlightenment model" perspective includes knowledge of fundamental personal, interpersonal, group, and organizational structures and processes of human behavior and cultures in order to fully understand deviance in a highly advanced technological world.

#### SUICIDE AND HOMICIDE

Short received his Ph.D. in 1951 from the University of Chicago under the tutelage of renowned sociologists William F. Ogburn and Ernest Burgess. When Short began his graduate studies in 1947, the Chicago School was well on its way to becoming the most famous sociology department in the world—unsurpassed in scholarship and research. During his studies, Short grappled with the unresolved dilemma of social science versus social action. He credits Ogburn for persuading him that the scientific study of social ills offers more effective input toward solutions than individual efforts at reform. Burgess further instilled in him the virtues of tenacity, courage, and intellectual flexibility in the exploration of problems and the use of methodology. His dissertation work, *Suicide and Homicide*, was published in 1964.

Short's scholarship endeavors also have included delinquency, gangs, suicide, homicide, and theory. As of 2003, he was a professor emeritus in sociology at Washington State University and has served as president of the American Society of Criminology. He was the recipient of the Edwin Sutherland Award in 1979. In retirement, Short continues to pursue his career and publications.

#### SEE ALSO

risk analysis; Toxic Substance Control Act; employee safety.

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## Shover, Neal (1940–)

A LEADING FIGURE in research and publication concerning white-collar and corporate crime, Neal Shover was raised in Columbus, Ohio, and went to public schools in an inner city, working class, racially diverse neighborhood. He received his B.S. degree in social welfare from Ohio State University in 1963. From 1964 to 1966, he was a prison sociologist at Illinois State Penitentiary at Joliet. He completed his M.A. degree in sociology at the University of Illinois, Urbana-Champaign in 1969, subsequently completing his Ph.D. there in 1971. In the early 2000s, Shover was a professor of sociology at the University of Tennessee, Knoxville, where he started his career in 1971.

Shover began publishing in 1978 with the book chapter, "Defining Organizational Crime" in a text on corporate and governmental deviance. This was a significant work in terms of establishing the parameters of the field. A major amount of his early writings concerned regulatory laws and surface-coal mining, including the role of inspectors.

While there has been much written on police roles and behavior, little was known about inspectors in the regulatory arena. This was particularly significant since workplace deaths and injuries take a larger toll than criminal deaths and injuries and many are the consequence of negligence. Thus, he was one of the early advocates of criminalizing such behavior. He has also contributed to developing the theoretical explanations of corporate crime through his published work.

Shover's book, *Crimes of Privilege: Readings in White-Collar Crime*, helped to further the work in this area. In 2004, Shover published *Doing Deals and Making Mistakes: The Challenge of White Collar Crime*. He has also published in the area of telemarketing crimes, and tax avoidance and evasion. Besides the white-collar and corporate crime area, Shover is also widely published in the areas of career thieves and corrections (prisons). He published

one of the early texts in corrections, *A Sociology of American Corrections*, in 1979 and later published a book on career thieves, *Pursuit and Careers of Persistent Thieves*, in 1996. He has been a visiting fellow or scholar at numerous institutions ranging from the U.S. Department of Justice and the National Institute of Justice to the Australian National University in Canberra.

#### SEE ALSO

prisoners; workplace deaths; negligence; Justice, Department of.

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## Silkwood, Karen (1946–1974)

KAREN SILKWOOD was killed in a car accident on November 13, 1974, while on her way to meet with officials to expose the physical negligence occurring at the Kerr-McGee's plutonium fuels production plant in Crescent, Oklahoma, where she worked as a chemical technician. The attempt to destroy her reputation and the subsequent cover-ups are worthy of the best mystery thrillers. Indeed, a Hollywood movie was made of her life story. Several crimes were committed in the Silkwood case: she was purposely exposed to radiation, harassed, then allegedly murdered.

Silkwood was born in Longview, Texas, the daughter of William and Merle Silkwood. She was a straight-A student throughout school and particularly enjoyed chemistry. She studied medical tech-

nology at Lamar College in Beaumont, Texas. In 1972, Silkwood was employed as a metallography laboratory technician at the Kerr-McGee Nuclear Corporation's plant at the Cimarron River site near Crescent, Oklahoma.

Kerr-McGee's business tentacles reached up to the highest government levels. Silkwood had participated in the union strike against the company and thereafter served on the union's bargaining committee. Her task was to monitor the plant's health and safety practices which she found to be problematic with leaks, spills, falsification of records, inadequate training, health regulation violations, poor quality control, and even some missing amounts of plutonium. The Atomic Energy Commission (AEC) inquiry led to her testimony about the dangerous safety practices at the plant. Kerr-McGee deemed Silkwood a troublemaker.

#### RADIATION EXPOSURE

During the week of November 5, 1972, Silkwood was repeatedly exposed to radiation on various parts of her body. Traces of plutonium were found by Kerr-McGee officials in Silkwood's apartments; she attributed this to spilling her urine sample and trying to clean it up. She was sent to the Los Alamos, New Mexico, laboratory on November 11 for testing and found to be within range of the acceptable levels of radiation. Unknown to her, Silkwood had been followed, watched, and had her telephone bugged for a number of months.

On November 13, Silkwood planned to meet a union official and a *New York Times* reporter and to provide them with evidence concerning negligent safety regulations. She carried a brown manila envelope that contained her documentation. On her way to the meeting, Silkwood was allegedly run off the road, crashed her car on a concrete abutment and sustained fatal injuries. According to state troopers, the cause of death was due to falling asleep at the wheel. Her autopsy revealed that Silkwood had been exposed to dangerously high levels of radiation. The documentation she was carrying was never found. Although a considerable amount of evidence exists that she was purposely killed, a conspiracy to cover up the faulty company practices and Silkwood's death have never been confirmed.

The resulting Silkwood estate civil suit, charging for personal injury and punitive damages against Kerr-McGee, was awarded \$10.5 million in 1979.



However, this amount was reduced to \$5,000 for personal injury upon appeal. The case was not settled until 1986 when an out-of-court settlement awarded the estate \$1.3 million. The Kerr-McGee industrial plant at Cimarron River was closed in 1975.

#### SEE ALSO

Kerr-McGee; employee safety; whistleblowers; employee safety; unions.

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## Simpson, Sally (1954–)

AFTER RECEIVING A Ph.D. in sociology from the University of Massachusetts, Amherst, Sally Simpson secured a post-doctoral research fellow position at Harvard University's business school and then joined the faculty at the University of Maryland. Her research in corporate crime has spanned a wide range of topics including: the intersection of criminological theories and explanations of corporate criminality, measurement of corporate crime, antitrust offending, and corporate crime control.

In addition to numerous studies directly testing the assumptions of traditional criminological theories' (such as deterrence, strain, and low self-control) applicability to corporate offending, Simpson, along with Raymond Paternoster, posited a rational choice model of corporate crime (1993). Their subjective, expected utility model privileges individuals over organizations as actors and decision-makers, but recognizes that the individual's calculation of cost and benefits will incorporate both personal and organizational factors.

In order to overcome the paucity of corporate crime data sources, Simpson has engaged in several data collection efforts. On two separate occasions, she administered vignette surveys to M.B.A. and executive education students as well as to a group of managers from a Fortune 500 company. Addition-

ally, she has amassed one of the few longitudinal data sets that details antitrust offending.

More recently, Simpson assessed the effectiveness of corporate crime control with attention focused on the increasing use of criminalization and punitive legal penalties for corporate violators. Her research examines a corporate crime deterrence model juxtaposed against compliance strategies, and she concludes that deterrence strategies are ineffective in controlling corporate misbehaviors, but that compliance strategies built on a foundation of self-regulation and cooperation may hold some promise for effective control.

In addition to her work in corporate crime, Simpson also works in the areas of criminological theory and gender and crime.

#### SEE ALSO

compliance programs; prosecution; antitrust.

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## Sinclair, Upton (1878–1968)

AMERICAN NOVELIST, essayist, muckraker, and socialist economic reformer, Upton Sinclair was born in Baltimore, Maryland, to Upton Beall and Priscilla (Harden) Sinclair. His father's alcoholism severely affected the family's stability and living conditions; his mother hated alcohol and caffeine. Sinclair began publishing dime novels when he was 15 (five years after the family moved to New York City), and while attending New York City College, he wrote pulp fiction to finance his education.

He enrolled at Columbia University in 1897, producing under pseudonyms in his spare time, the Clif Faraday and Mark Mallory, stories for boys' publications. Sinclair began reading the *Appeal to*

*Reason*, a socialist-populist newspaper, and then joined the American Socialist Party when he was 24 years old.

Sinclair's most famous work and only best-seller, the historical fiction novel *The Jungle* (1906), is much more remembered for its political effects than for its literary contribution. In 1905, *The Jungle* was serialized in *Appeal to Reason*. Doubleday agreed to publish its entirety in 1906. It was dedicated to the workingmen of America, and educated the public about the horrors of the meatpacking industry in Chicago ("Packingtown"), including the ways in which meats delivered to consumers were contaminated. Widespread outrage and boycotting aimed at the meat industry shortly followed, and the government quickly passed in 1906 the Pure Food and Drug Act and the Meat Inspection Act. The legislation occurred during the Progressive Era, representing America's first national consumer protection laws, and it was a clear indication that the federal government was no longer following a hands-off attitude toward business.

The Pure Food and Drug Act may be seen as an example of "structural Marxism"—when laws are enacted in order to promote the viability of a capitalistic system. Unless confidence was restored in the marketplace, all of the economic role participants in the meat industry—farmers, butchers, railroads, grocery stores, packing houses—would be adversely affected. Even though the initial cost of implementing the law may not have been in participants' best interests, the law was nevertheless necessary to prevent economic disaster.

*The Jungle* depicts the experience of protagonist Jurgus Rudkus, a Lithuanian immigrant who came to America with dreams of wealth, success, and happiness. Rudkus found only price-gouging, corruption, wage-slavery, and unsafe working conditions, causing him ultimately to become a socialist. Sinclair tried to demonstrate in *The Jungle* that capitalism is an attack on the American Dream that states that hard work leads to financial success. He also tried to convince the reader that socialism is the remedy for the evils of capitalism. The slaughterhouses and pens at Packingtown were to symbolize the plight of the working class—both the animals and the workers were at the mercy of the owners of Packingtown.

*The Jungle* is a metaphor for capitalism, portraying it as a system based on competition and self-gratification, in which only the strongest survive. As

a historical novel, *The Jungle* is said to have had the most significant political impact since Harriet Beecher Stowe's *Uncle Tom's Cabin*. President Theodore Roosevelt, moved by *The Jungle*, ordered federal investigations of the meatpacking industry which led to the passage of the pure food laws. It was soon translated into 17 languages and became a worldwide bestseller.

Although only a dozen of the more than 300 pages in Sinclair's novel were devoted to the horrors of the meatpacking industry, the book had a profound effect on public opinion. A familiar rhyme was parodied in the press after the publication of *The Jungle*: "Mary had a little lamb, and when she saw it sicken, she shipped it off to Packingtown, and now it's labeled chicken!" Sinclair later said, "I aimed at the public's heart and by accident I hit it in the stomach."

Income from *The Jungle* enabled Sinclair in 1906 to establish and support a commune for left-wing writers called the Helicon Home Colony in Englewood, New Jersey. It burned to the ground within four months, and Sinclair claimed the fire to be arson committed by political opponents. After a short residence in Croton-on-Hudson, New York, Sinclair moved to Pasadena, California, in 1915 where he lived for almost 40 years. Having set an exposé style based on *The Jungle*, Sinclair wrote *The Metropolis* in 1908 (about New York high society), *King Cole* in 1917 (about the 1914 Colorado miners' strike), *Oil!* in 1927 (about the Warren Harding administration's Teapot Dome scandal), and *Boston* in 1928 (about the controversial 1920-21 Sacco-Vanzetti robbery-murder case in that city; Sacco and Vanzetti were executed in 1927). Right after World War 1 ended, *Jimmie Higgins* (1919) was published as a representation of the internal conflicts experienced by American leftists who felt a duty to support the most prosperous citizens of England and France during war. In the 1920s, Sinclair was a major contributor to the founding of the American Civil Liberties Union.

Sinclair ran for the California governor's office in 1924 as a socialist and again in 1934 as a Democrat. In the 1934 race, Sinclair put forth his EPIC Plan (End Poverty in California), a proposed solution to the Depression that pushed the state of California to rent idle lands and factories to the impoverished for self-survival. He easily won the primary, but lost the election (with 43 percent of the vote) when conservative Democrats supported

the anti-New Deal Republican candidate, Frank Merriman. Sinclair's candidacy was smeared badly by Merriman through contrived newsreels showing hordes of homeless Americans invading California and by associating EPIC with socialism, including alleging Sinclair favored the "nationalization" of children.

His writing continued to be fertile during 1940 to 1953 when his *Lanny Budd* series of 11 contemporary anti-fascist historical novels was published. Budd was the illegitimate son of a munitions tycoon, later an American secret agent, who always found himself around important people at critical points in history. *Dragon's Teeth* (1942), about the rise of Nazi Germany, won the Pulitzer Prize for fiction in 1943 (Sinclair's only major literary award). The last novel in the series, *The Return of Lanny Budd* (1953), centers on Cold War politics between America and the former Soviet Union.

Sinclair moved to Buckeye, Arizona, in 1953. He published *My Lifetime in Letters* in 1960 and *The Autobiography of Upton Sinclair* in 1962. Sinclair died in his sleep on November 25, 1968 in Bound Brook, New Jersey.

#### SEE ALSO

Meat Inspection Act; Pure Food and Drug Act; Roosevelt, Theodore.

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## Singapore

SINGAPORE IS A SMALL island city state that was, until its separation in 1965, part of Malaysia. As a former British colony, much of its legal system and business practices are based on British models. In the case of Singapore, it has been the government that has been the leading driver of economic development and government-linked companies (GLCs), together with multinational enterprises, have been the most influential actors in business. The economic downturn of the mid-1980s persuaded the

Singaporean government of the importance of entrepreneurship in addition to the existing driving forces, and thus, it has encouraged Singaporeans to conduct their own overseas foreign investment. In doing so, some entrepreneurs have used their own personal networks and, while there is no suggestion of impropriety, it has reduced the level of transparency in Singaporean business dealings.

The majority of Singapore's more than three million people are ethnic Chinese, with smaller numbers of Malays, Indians, and others. Singapore has become known as one of the most economically and technologically advanced societies in Asia; it has been run by the People's Action Party (PAP) since its founding and that party has become almost institutionalized as the government, albeit in free and fair elections. The PAP is well-known for its paternalistic style and its sponsorship of Asian values. Partly as a result of this and partly because of an earlier perceived need to defend Singapore against the twin dangers of mainland Chinese triad gangs and communism, Singapore has a strict criminal justice system with sentences readily enacted.

To maintain business confidence, Singaporean leaders are keen to make it known that the city has a very low crime rate and is secure for multinational companies. However, it is ironic that any opposition to the PAP from trade unionists, or even non-political figures, has regularly been met with official revelations that the dissidents are in some ways part of international conspiracies and guilty of a wide array of crimes. Foreign media disseminating stories that the ruling party considers detrimental to the party or to individuals within it have been struck with severe financial penalties, resulting from libel actions in which Singaporean courts interpret the law in ways which are generous towards plaintiffs.

The current vogue for promoting business interests above social ones, which has long been attractive to Singaporean leaders, requires a reduction in regulations and bureaucracy which has made it easier for businesses and business people to commit crimes. The introduction of e-commerce and other information technology systems has also provided avenues for new crimes such as cybercrimes, which include online fraud, credit card theft, and theft of identities, as well as hacking websites, and cracking software and systems. A survey by KPMG in 2002 found that fraud in business was considered to be a growing threat and was an ever-present aspect of business, with nearly half of the business executive



*Singapore's business district has links to organized crime and smuggling operations, but overall remains a relatively secure and civil society in which to conduct business in southeast Asia.*

respondents acknowledging that they had witnessed fraud of some sort in their own organizations. Singapore has strongly emphasized the development of information technology skills as part of its development model. Ironically, the skills engendered offer opportunities for crime for which international policing protocols have yet fully to be established.

The desire by Singaporean authorities to promote the island as a secure home for international business has meant that most sectors are adequately regulated and policed. However, regulation itself cannot prevent instances of poor management practices leading to fraud, as the activities of Nick Leeson at Barings Bank demonstrated. Leeson's futures trading losses were catastrophic for his employers but there was also culpability in the firm's own internal management practices in allowing Leeson to hide his activities for so long. Singapore has a sex industry linked to organized crime and some intellectual property piracy of computer software and CD entertainment disks. However, a more important

issue is that of smuggling and trans-shipment of smuggled goods, which in some cases have been linked with piracy in the South China Sea. Nevertheless, Singapore remains a comparatively secure base for business in southeast Asia.

#### SEE ALSO

Barings Bank; Leeson, Nick; Asia; public corruption.

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## small-business fraud

ACCORDING TO the Association of Certified Fraud Examiners (ACFE), a leading anti-fraud organization, small businesses are particularly vulnerable to fraud, and are even more likely to become the victims of fraud than larger businesses. The classification of a business as small usually refers to those businesses with a total of less than 100 employees. In a 2002 study conducted by the ACFE, losses to small businesses that were estimated on a per-employee basis were approximately 100 times greater than those losses in large businesses (classified as having 10,000 or more employees).

The average fraud loss in small businesses was approximately \$127,000 in 2002. Other estimates state that losses due to fraud may cost small businesses around 6 percent of their annual revenue. The ACFE and other anti-fraud professional organizations provide extensive information on the topic of small-business fraud, including examples of different forms of fraud, and also potential steps that businesses can take to prevent fraud victimization.

Like any company, small businesses may be victimized by fraud both within and from outside the organization. Fraud from within is committed by employees against the business, while fraud from outside often is committed by vendors or potential vendors offering to provide services to the business. Regardless of the type of fraud that occurs, experts in the field agree that the key to prevention starts with awareness. If small businesses begin by recognizing that fraud is a possibility, they can then take the appropriate steps to detect and prevent fraud. Businesses should accept the fact that fraud is very common, and can happen to anyone at any time. An appropriate ethical standard should be developed to deal with both employees and outside associates even if the business feels very close to them. Many recent examples have shown that fraud may be more likely when there is too much trust by businesses.

### INSIDE THE COMPANY

According to the ACFE, fraud from within takes three common schemes: asset misappropriation, corruption, and fraudulent statements. Asset misappropriation is broader than simple employee theft, and can be sub-divided into two forms: the misappropriation of cash, and the misappropriation

of non-cash (such as company supplies). The misappropriation of cash occurs more often than the misappropriation of non-cash, and the ACFE estimates that this is because cash is easily expendable—there is always a readily available market for spending money, but other assets may not be so easily discarded or translated into cold, hard cash. The cash funds of any business can be vulnerable in three distinct areas: skimming, larceny, and fraudulent disbursements.

Skimming takes place when an employee steals money from the business before it is ever accepted and recorded by the business. For example, a salesperson could take cash for a transaction without entering the transaction into a business cash register. Another potential perpetrator of skimming could be an employee in the business accounting department, who similarly does not record a transaction on the books and instead pockets the cash. Alternatively, larceny refers to the theft of cash or currency that occurs after a business has already received or recorded the transaction. In a small business setting, larceny is most often perpetrated by cashiers, or other employees who are given easy access to currency. However, the ACFE states that larceny schemes are uncommon and do not typically result in large losses, because currency typically is closely monitored.

In comparison, fraudulent disbursements represent the greatest cash losses to small businesses. This type of scheme refers to actual fraudulent disbursements from the business accounts. Unlike skimming and larceny, the nature of this form of fraud usually means it is limited to employees in the accounting or bookkeeping department of the business. A likely example is a fake invoice submitted to the company for reimbursement, which is then unsuspectingly paid by the business. Common fraudulent disbursement schemes identified through the ACFE's research have involved false billing for services to the business that are never rendered. The perpetrator of this kind of scheme can conceal such illegal reimbursements by directing checks to be paid out to friends, relatives, or even fictitious companies.

Non-cash asset misappropriation is not as common, but when it occurs, it may involve the theft of a commodity that is personally appealing to the perpetrator. Typical examples include such assets as electronic devices and computers, clothing and jewelry, or a variety of other valuables.

Corruption, the second type of occupational fraud perpetrated from within, is not as likely as asset misappropriation, but can be even more costly to the small business. Corruption differs from asset misappropriation in that it involves some form of a conspiracy between an employee and one or more parties outside the business. The ACFE discusses examples of corruption that include attractive offers from vendors such as free trips, enticements or discounts that result in the occurrence of a bribe. The small business is victimized when it ends up paying higher prices for the vendor's services, or alternatively, receives inferior services.

Finally, fraudulent statements, the third kind of fraud that is perpetrated from within, occurs when employees mis-state the organization's financial information. This type of fraud is costly, but occurs

mainly in larger organizations and is therefore not a significant risk to the small business.

#### OUTSIDE THE COMPANY

Fraud against small businesses that is committed from outside the company is typically perpetrated by vendors or potential vendors seeking a relationship with the business. Small businesses have increasingly been targeted by a variety of scam artists, many of whom fraudulently induce the business to pay for services never rendered or products never delivered. Much like the different ways in which employees can perpetrate fraud, outside offenders may use a number of deceptive techniques to victimize a small business. For example, they may send fake invoices requesting payment for items never or-



*If a cashier in a small retail business "skims" from the cash register, it may constitute the commission of larceny. Such employee crimes are one kind of fraud facing small businesses.*



*A typical small business owner contends with fraud within the company and from outside relationships.*

dered, offer prizes as an inducement to purchase overpriced supplies and office equipment, or even send fake yellow page directory advertisement renewal forms which are actually contracts for the business to advertise in other directories.

With recent increases and advances in technology, small businesses may also be particularly vulnerable to outside fraud schemes involving computers and other common electronic transactions. These types of fraud can be perpetrated by vendors and customers of the small business. For example, various forms of check fraud can occur in many kinds of businesses, but the small business may find it more difficult to recover from a resulting loss. Check fraud may include counterfeit checks or forged checks, which are used to purchase merchandise or other products from the small business. This form of fraud from outside has increased considerably due to technological advances like laser printers and sophisticated computer software programs, both of which now make a phony check

less likely to be detected. Similarly, credit card fraud is also often perpetrated against the small business. Stolen credit cards may be used to purchase merchandise from the business. Additionally, credit cards that are altered to represent non-valid or non-existent accounts may be used in a small business. The recent increase in cases of identity theft makes the possibilities of both check fraud and credit card fraud even more likely. In these situations, the perpetrator illegally obtains identifying information, such as a driver's license or social security number, from an unsuspecting individual. The offender then fraudulently obtains credit in the victim's name. Resulting sources of credit, such as major credit cards, may then be used for transactions with the business.

## FRAUD RISK

How does a company identify whether it is at risk for fraud? Executives should be made aware of three major risk factors that contribute to small-business fraud. These include inadequate employee pre-screening, limited controls, and too much trust. The first factor applies to cases of fraud from within, while the second factors apply equally to both internal and external frauds that may be perpetrated against a small business.

Inadequate employee pre-screening, the first risk factor, often occurs because small businesses rarely have the funds needed to complete thorough screenings of potential employees. Although small businesses may limit pre-screening to save costs, this may ultimately result in great losses due to fraud. Unlike larger companies, small businesses do not consistently check background information such as prior work references or criminal records of potential employees. Additionally, other pre-employment practices that are common in larger businesses, such as drug-testing or psychological testing, are rarely performed by small businesses due to the costs of these procedures. This fact may be obvious to the fraudster, who will take advantage of the limitation and seek employment at a small business. While it is estimated that only less than 10 percent of employees actually have a criminal record that includes prior acts of fraud, it is this small proportion that can end up doing the most damage in a small business. Investment in thorough pre-screening practices is therefore vital to the small business seeking to prevent fraud victimization. The second risk factor for fraud, limited controls, refers to the



*The abuse of trust in a small business environment, where owners and employees become well acquainted, can lead to employers overlooking key fraud signs from a particularly likeable worker.*

common division of labor in a small business setting. While larger organizations often have an entire, multi-staffed department that is responsible for accounting and bookkeeping functions, the nature of the small business dictates that this role is often performed by a single employee. Even if the small business does not regularly conduct audits, a more limited consultation with a Certified Public Accountant (CPA) can show the employer potential fraudulent schemes. The CPA may also perform verification functions by certifying the information reported by the company's internal accountant. The ACFE suggests that small businesses consider conducting regular, external audits. If this oversight is made known to small business employees, particularly the one-person accounting department, the mere knowledge that an audit will occur can serve as a powerful fraud deterrent. Studies have also shown that an unexpected audit can be a valuable tool in detecting fraud, because deceitful employees

will not attempt to cover up their fraudulent activities if they do not expect an investigation.

### THE TRUST FACTOR

The third risk factor for fraud in small businesses, too much trust, can potentially be remedied without a great deal of financial expense to the business. Referred to as the human element of the workplace, trust is an important factor in any business setting. While large businesses may be less intimate because various employees rarely interact with one another, the small business setting holds a greater degree of intimacy. In fact, it is this element that may make working at a small business particularly desirable to potential employees. In a small business setting, employees are more likely to be well acquainted with each other, and interact on a regular basis inside and outside the workplace. The majority of the time, trusting and believing in one's employees is a valu-



able asset, but can sometimes lead to large fraud losses. Just as a complete lack of trust may be detrimental, so, too, is absolute faith in one's employees. As the ACFE's extensive study revealed, trust can be both an essential element in sound business transactions as well as a critical element in fraud.

To prevent other forms of fraud from within, research has shown that small businesses can benefit from implementing a code of ethics: the ethical tone, or climate, in businesses is set by the employer. It is particularly important that employees are treated fairly, because feelings of inequity or anger toward the business can lead directly to fraud. Employers or owners can prevent potential, perceived inequity by regularly interacting with their employees, and even engaging in interactive discussions about fraud. A clearly defined policy on fraud from within is also a critical step.

In addition to the trust factor between employees and employers, trust relationships with outside vendors are also subject to fraud victimization for the small business. Several strategies may be used to avoid being a victim of fraud by outside entities. For instance, one simple step that small businesses can take is the verification of all invoices. All incoming invoices sent to the small business should go through a verification procedure before a payment is made. Employees responsible for the reimbursement function can be assisted in this process by providing them with a list of the contact names, addresses, and phone numbers for all vendors that the company contracts with.

With regard to various frauds that may be perpetrated by customers, the small business also has several relatively simple options to protect itself. For example, check fraud and credit fraud can be easily prevented with education. If small businesses do not intimately know their customers by name, training for employees who accept checks and credit cards can make detection more likely. Counterfeit checks tend to be of very poor printing quality. Personal checks will always have one perforated edge, so employees should make sure this is the case for all non-government checks, which have four smooth sides. Signatures on checks should also be closely examined by cashiers or other employees who accept payments.

Numerous investigations of check forgery have shown that forged signatures may often reach past the regular signature line on the check, due to the fact that the forger has limited experience in signing

the victim's name. Another common tip to a forged check is a newly opened account, which investigations have found are more vulnerable to fraud. It may be possible for cashiers to determine the age of an account if this information is printed on the check. Lower numbers on checks may also indicate a newer account, and thus, a potentially forged check.

There are also several signs to look for in detecting credit card fraud. Just like check fraud, the key line of defense for the small business is the education of its employees. The small business cashier should be wary of alterations in a credit card's signature panel, which may suggest that the signature has been removed and replaced with a fake one. If the signature does not appear to be altered, another line of defense for the small business is to verify the signature by asking the customer for a form of photo identification.

In addition to obvious signature abnormalities, alterations on the face of a credit card can be a noticeable sign of fraud. This may be in the form of obviously changed numbers or expiration dates on the card. A limited amount of numbers may appear to be altered, or a phony card could even be flattened and then re-stamped with an entire set of new numbers. In some cases, stolen or invalid credit cards may be badly discolored, or even show signs of glue or paint on their surfaces. Electronic verification systems for both checks and credit cards may be initially costly to implement, but could be invaluable to the retail business.

Regardless of whether fraud is perpetrated from within or outside the small business, it is apparent that many of the obvious red flags and warning signs are often ignored. Education is one of the most effective methods small businesses can use in preventing fraud. Relatively minor investments in education, training, and awareness in the short term can result in the elimination of potentially devastating, long-term fraud losses to the small business.

#### SEE ALSO

employee crimes; embezzlement; contractor fraud; bribery; forgery; bad checks; credit card fraud; identity fraud.

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## South America

IN THE LATE 20th century and into the early 21st century, organized and white-collar crime became a major issue South America. Much of this criminal activity has revolved around the illegal drug trade and associated money laundering. There have also been concerns that international terrorists will be able to take advantage of the continent's financial systems to launder money. In response to these problems, in 2002 the Inter-American Development Bank approved \$1.2 billion to fight money laundering in eight South American countries. Carried out through the Organization of American States, the countries apply the funds to create or strengthen financial intelligence units that will track suspicious transactions of suspected money launders.

### BOLIVIA

Most organized crime in Bolivia is related to the cocoa growing industry. Since the 1960s, Bolivian governments have pledged to eradicate cocoa crops. Despite such promises, cocoa cultivation has expanded and transnational criminal organizations have played a growing role in the country. Often family-based, these organizations have established links to the police, the armed forces, politicians, and international criminal networks. International attention to organized crime related to the drug trade has concentrated on Colombia, allowing Bolivian groups to expand and take a more active role than is often assumed.

Organized crime associated with cocoa and cocaine production in Bolivia dates back to 1940. There was an increase in international criminal activity in the country during the 1950s due to improved communications capabilities, particularly air traffic in and out of Bolivia, which in turn al-

lowed Cuban drug traffickers to import cocoa paste from Bolivia. This criminal activity grew even more during the military governments from 1964 to 1982, as international demand for cocaine grew and Bolivians made connections with Colombian drug cartels.

The Santa Ana cartel, sometimes known simply as *La Corporación* (The Corporation), dominated organized crime in Bolivia starting in the 1970s. Led by wealthy cattle rancher Roberto Suarez Gómez, the Santa Ana cartel got its start by supplying cocoa paste to Colombian drug traffickers. By the late 1970s, the cartel was monopolizing the production and commercialization of cocaine in Bolivia. Soon, the organization became independent of the Colombians, shipping cocaine to the United States through Mexico and bringing back millions of dollars to launder. *La Corporación* was also increasingly involved in politics and the armed forces, and was apparently behind the 1980 military coup that brought General Luis García Meza to power. The Santa Ana cartel also has been linked to former Nazi Klaus Barbie, who arrived in Bolivia in the 1950s and was involved in many illicit activities.

### VENEZUELA

During the 1980s, oil revenue in petroleum-rich Venezuela declined sharply. The economy became increasingly affected by the drug trade and money-laundering because Colombian cartels, the Sicilian Mafia, and Venezuelan politicians and bankers all sought to profit. Large amounts of the cocaine shipped to the United States and Europe passed through Venezuela, and those involved earned perhaps \$2 billion in narcotics profits.

Much of the illicit activity came to light during the administration of Carlos Andrés Pérez (1989-1993). Pérez appointed Thor Halvorssen as his anti-drug czar. Halvorssen also became the special overseas investigator for the Venezuelan Senate's Anti-money Laundering Commission. He began investigating Banco Latino, Venezuela's second largest bank. Halvorssen soon discovered that the president and his mistress had put away \$19 million in secret accounts, which led to the impeachment of Pérez in May 1993. Later that year, clear evidence of money-laundering schemes in Venezuelan banks came to light, especially those involving Banco Latino. Banco Latino and numerous other Venezuelan banks had shifted many of their assets to off-

shore facilities to avoid the country's currency controls. In turn, Colombian drug traffickers used the Venezuelan banking system and its offshore subsidiaries to launder their earnings. Banco Latino and other banks collapsed, Pérez was indicted in the money-laundering operations, and more than 300 bankers and businessmen were arrested, while others fled the country.

In addition to these money-laundering operations by Venezuelan bankers, organized criminals connected to the Italian Mafia have operated in Venezuela. The most well known was the family of Pasquale Cuntrera. These Italian citizens operated in Venezuela as businessmen and have been routinely accused of Mafia connections in Italy. Cuntrera was removed from Venezuela by Italian officials and sentenced to 21 years in prison. However, he disappeared from an appeals hearing in 1998, only to be arrested later that year while trying to board a plane to Venezuela. A major Italian-Venezuelan narcotics operation also led to the arrest of 50 others. These criminals connected to the Italian Mafia transport cocaine and heroin through the Caribbean to Europe. Much of their money is then laundered in the Caribbean and elsewhere.

## PERU

Organized crime centered around the drug trade has been active in Peru since its transition to democracy in 1980. The administration of Fernando Belaunde Terry (1980–85) was marked by charges of corruption and connections to the drug traffickers. The situation became worse during the administration of Alan Garcia (1985–90). The nationalistic Garcia deposited large sums of Peru's foreign exchange reserves in the Bank of Credit and Commerce International (BCCI) as part of a plan to renounce the country's foreign debt. Garcia used such offshore facilities to protect the funds from the International Monetary Fund (IMF) and commercial creditors.

In 1991, an indictment against BCCI claimed that the bank had paid \$3 million in bribes to top officials at Peru's Central Bank. In exchange, Peruvian authorities agreed to deposit government funds into BCCI accounts in New York. The New York District Attorney's office raised this issue, which led to investigation in Peru. Rumors abounded that Garcia knew about the bribes. To make matters worse, accusations by Peruvian legis-

lators claimed that the former president stole as much as \$50 million while channeling the funds through BCCI. Rumors even circulated that Garcia had been introduced to BCCI by Panamanian strongman Manuel Noriega. Indeed, Garcia apparently deposited funds in BCCI accounts in Panama before transferring them to other accounts in his wife's name.

Garcia claimed that political opponents who were trying to discredit his possible presidential campaign in 1995 made the accusations. Nevertheless, Garcia fled to Paris, France, rather than face charges and his APRA political party was largely discredited. In a turn of events, Garcia returned to Peru and ran for president in 2001. While he did not win, he made an impressive showing despite his checkered past.

## COLOMBIA

Organized and white-collar crime in Colombia centers around the production and sale of illegal drugs, particularly cocaine. Due to the large amount of money involved in the illegal narcotics trade, money laundering has also become a key issue in Colombia. Furthermore, there is pervasive manipulation of the country's political system by those in the drug trade. Colombian traffickers consistently bribe high-level officials of the central government to create a more crime-friendly environment in which authorities protect and support illegal activity. The power and wealth of organized crime in Colombia can be seen in activities that include being able to negotiate judicial leniency, creating paramilitary groups to fight leftist insurgents, and the contribution of drug money to political campaigns.

The presence of drug cartels in Colombia has led to numerous money-laundering operations in the country. Among the more famous was La Mina, which operated from 1985 to 1988. Associated with the Medellín cartel, La Mina was the largest cocaine money-laundering operation up to that time, washing more than \$1 billion. The system revolved around gold trading, because the sale of the precious metal could justify large cash transactions. Early in the operation, gold-plated lead was shipped from Uruguay to the United States and "sold" to drug traffickers. The gold seller then transferred the funds to cartel accounts. In a later phase, Colombian traffickers in the United States purchased gold in Los Angeles with drug profits and sent the gold

to New York City, where it was then resold to banks. The Colombians then wired the money to banks in Panama. This sophisticated operation was eventually broken up by U.S. law enforcement.

Another prominent Colombian money-laundering scheme was organized by José Santacruz Londoño, one of the leaders of the Cali cartel. Between 1988 and 1990, this operation laundered hundreds of millions of dollars from drug sales in New York. The organization deposited the profits in U.S. banks or shipped them to Panama. Then the money was funneled into a front company known as the Siracusa Trading Company. This company then transferred the funds to European accounts. Finally, from these European accounts, the money was sent back to Colombia, where it was converted to pesos by money exchangers for use by the cartel.

An additional money-laundering trend that arose in the 1990s was the washing of funds through trade. Colombian "peso-brokers" bought drug dollars at a discount in the United States and stored them in stash houses until they could gradually deposit the money into bank accounts.

The brokers then sold the dollars to Colombian business people who needed them for imports. The importers were given a discount off the official exchange rate and also were able to avoid taxes. They then bought goods ranging from clothing and liquor to computers and appliances from U.S.-based companies. Thus, the laundered money ends up in the hands of U.S. corporations.

#### SEE ALSO

Brazil; organized crime; drug trafficking; money laundering; corruption.

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## Spain

A DECADE AGO, corruption was a serious problem in Spain, but acts of high-level corruption are far less evident today. Other forms of white-collar crime, however, are a serious problem in Spain. Media and domestic government reports routinely cite the proliferation of embezzlement, insider trading, consumer fraud, counterfeiting and tax evasion. Unfortunately, Spanish agencies that investigate white-collar crimes must compete for resources earmarked to prevent all forms of criminal behavior. Consequently, most government funds are budgeted to combat violent crimes, especially crimes linked to the influx of organized criminal networks into Spain over the past two decades.

The cultural and linguistic ties to Latin and South America and close proximity to Eastern Europe and Africa make Spain a haven for organized criminal gangs from disparate parts of the globe. Since the 1980s, organized criminal groups routinely traffic cocaine from Latin and South America to Spain.

Another grave problem arose in the mid-1990s, as organized criminal gangs from Eastern Europe purchased real estate and other assets in Spain with the proceeds of corruption, stolen state property, and money laundering from their home countries. Currently, Spain maintains a substantial presence of criminal gangs from Colombia, Italy, France, Great Britain, Morocco Portugal, and Turkey. Criminals from the former Soviet Union have also taken up residence in Spain, and some have been arrested for such activities as extortion, document fraud, and money laundering. Organized criminals and corrupt businessmen from the former Soviet Union and surrounding countries live in Spain and have also invested the proceeds of illicit activity in Spain, especially in real estate.

Organized criminal groups routinely transfer illegal proceeds through Spanish financial institutions. Spanish authorities conclude that nearly 23 percent of organized criminal activity pertains to money-laundering schemes. The value of laundered money held by organized crime in Spain amounts to about \$7.2 billion. The illicit funds are transferred through the sophisticated Spanish financial sector, which provides a wide array of institutions to launder illicit profits. Money changing at exchange bureaus, which exchange more than \$20 billion annually, is among the most important means of

laundering money in Spain. Moreover, internet gambling in Spain is a growing concern for domestic and international regulators and law enforcement agencies. Spain permits both physical and virtual gambling establishments, both lacking stringent oversight mechanisms, to operate from Spanish territory.

Spanish authorities respond to threats from organized criminal groups in a timely fashion. As a result, Spain's formal anti-money laundering system is as good as that of any country in the world, with broad sectoral coverage and inclusion of all serious crimes. The 1993 Spanish anti-money laundering law covers the acquisition, use, conversion, or transfer of property derived from drug trafficking, terrorism, and organized crime.

Penalties to institutions or businesses for serious violations may include a private warning, a public warning, plus a fine of up to 1 percent of the equity capital of the entity, and other penalties. Penalties for individuals involved in serious offenses include a private warning, a public warning, or suspension of a license to practice business for one year. In addition, there is a mandatory fine for persons involved in serious offenses, of between 500,000 to 10 million pesetas per person, ranging from approximately \$3,000 to \$57,000.

The funneling of illicit profits from transnational organized criminal groups is a major concern for Spanish authorities. To assist in quelling the passage of illicit proceeds from abroad through Spanish financial institutions, Spain ratified a number of regional and international agreements. Spain is a member of the Financial Action Task Force (FATF), and an observer in the Caribbean Financial Action Task Force (CFATF).

Spain is also a signatory to the 2000 United Nations Convention Against Transnational Organized Crime. Spain signed mutual legal assistance treaties or bilateral counternarcotics agreements with most countries in Latin America, as well as with Morocco, and Turkey. Spain also has a mutual cooperation agreement with Russia for the exchange of information on money-laundering matters.

The domestic legislation and international conventions illustrate the high level of commitment to combat crime in Spain. Significant numbers of domestic and transnational criminal groups continue to challenge Spanish authorities, but the pro-active efforts to enforce Spanish and international laws will slow the illegal efforts of a host of white-collar

criminals and organized criminal gangs established throughout Spain.

#### SEE ALSO

corruption; public corruption; reform and regulation.

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TRIFIN ROULE

*JOURNAL OF MONEY LAUNDERING CONTROL*

## Spitzer, Eliot (1959–)

ELECTED NEW York attorney general in 1999, Eliot Spitzer gained national attention for his aggressive legal actions against Wall Street giant, Merrill Lynch. In 2001, Spitzer began investigating Merrill Lynch for promoting stocks of companies to which it had financial ties.

#### CRAP AND JUNK

Spitzer's investigation turned up e-mails from Merrill Lynch stock analysts indicating that the company routinely published favorable stock ratings for certain companies that they privately thought were of dubious value. One of Merrill's most famous analysts, Henry Blodget, was found to have called stocks "crap" and "junk" that had been given a strong recommendation to investors.

All told, Spitzer's office subpoenaed about 30,000 e-mails from which investigators pulled a number of similarly incriminating messages. To force Merrill Lynch to the bargaining table, Spitzer released the e-mails, outraging investors who had relied on Merrill Lynch investment reports, and causing the company's stock to drop by 12 percent over the next week.

Merrill's chief executive officer, David Kamen-sky, apologized to shareholders for the situation and several weeks later settled with Spitzer's office for \$100 million. More significantly perhaps for in-

vestors, Spitzer forced Merrill Lynch to agree to stop the practice of paying analysts for the number of companies they attracted to Merrill's investment banking arm.

Spitzer's interest in advocacy first took shape in college, when he lobbied the Princeton University administration to raise salaries for custodial and other service employees on campus. Upon earning his law degree from Harvard University in 1984, Spitzer bounced between public and private practice for several years, working as a clerk for a U.S. District Court judge, as an assistant district attorney in Manhattan, and, ironically, as a defense attorney for white-collar criminals at a prestigious private firm in New York.

In 1994, Spitzer, finding private practice uninteresting, ran for the New York state attorney general's office, using money borrowed from his wealthy father. Despite spending an estimated \$10 million, Spitzer lost in the primary. Four years later, however, after spending a considerable amount of time campaigning, Spitzer narrowly won the next election for the office by fewer than 25,000 votes.

One of Spitzer's first triumphs in office was bringing to conclusion a lengthy 30-year case between General Electric (GE) and the state over pollutants in the Hudson River. GE had allegedly used the river to dump PCBs (a chemical pollutant), creating a potential health risk for humans and wildlife. Spitzer's prosecution of GE led to the Environmental Protection Agency's ruling that GE was required to clean up the PCB pollution from the river.

Spitzer also brought environmental cases against sewage treatment plants and against several midwestern and southern power plants whose pollution drift, Spitzer alleged, created smog and acid rain in New York. He used the Clean Air Act to force those companies to improve their emission standards. Several of the companies settled and agreed to reduce emissions. Many New Yorkers see Spitzer as a champion of the common person over the corporate giant, a particularly compelling image in the wake of the corporate scandals of Enron Corporation, Global Crossing, and others.

#### SEE ALSO

Merrill Lynch; General Electric; Giuliani, Rudolph.

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## sports scandals

MOST sports, from tennis to cricket, have seen their fair share of white-collar crime, most notably bribery and illegal gambling. Perhaps the most famous sports scandal in American history, the 1919 Baseball World Series between the Cincinnati Reds and the Chicago White Sox, was corrupted by members of the White Sox being bribed to lose the World Series. A year later, eight members of the White Sox, including superstar Shoeless Joe Jackson, were banned from the game for life. However, while there is no doubt that players were bribed, there is great debate as to whether Jackson, who has the third-highest lifetime batting average in history (.356), under-performed to lose the series.

### SOX SCANDAL

Three of the prominent gamblers involved in the scandal were William Burns, Billy Maharg, and Joseph Sullivan. Burns and Maharg approached pitcher Ed Cicotte and first baseman Arnold Gandil, who agreed to the fix. In order to ensure that the series was indeed lost, more players needed to be a part of the bribe, which thus meant that more money was needed to pay off the added players. More gamblers were brought in to finance the scam, and because of the increase of people involved, word of the incident spread. It became obvious that something peculiar had occurred as heavy bets were being placed on the Reds winning, and the betting odds kept changing.

With the World Series then set in a best-of-nine format, Cincinnati won the first game, 9-1, with Cicotte pitching and giving up five runs in the fourth inning. The Reds also won game 2, but the White Sox were victorious in game 3. Cicotte was again the losing pitcher in game 4, and the Reds also won game 5. Chicago responded by then winning games

6 and 7, before Cincinnati won game 8, and thus the World Series. During the series, problems arose as the players who had been bribed were not receiving the money that they were promised. The victories in games 6 and 7 were a response by the Chicago players to try to win the series because they felt like they were being cheated by the gamblers who had not yet honored their agreement. However, prior to game 8, Chicago's starting pitcher, Lefty Williams, was threatened before the game by a thug hired by gambler Arnold Rothstein: if he did not lose, then something tragic would happen to his wife. A frightened Williams ensured a Reds' victory. It was a massive upset as Chicago was the much superior team.

In September 1920, a grand jury in Chicago's Cook County began an investigation into possible game fixing by the Chicago Cubs, and included the 1919 World Series. Cicotte and Jackson admitted their parts in the scandal, while Gandil remained silent. Baseball Commissioner Kenesaw Mountain Landis banned all eight players for life on August 2, 1921, following a not-guilty decision from the court. The other five players who were banned for life were Buck Weaver, Swede Risberg, Fred McMullin, Oscar Felsch, and Lefty Williams.

The biggest controversy over the fixed series was the involvement of Shoeless Joe Jackson. It is believed that Jackson was aware of the fix but initially refused to take any bribes. Gandil offered him \$10,000 to take part, but Jackson still refused. Jackson ended up taking \$5,000, largely because the fix was already in place. However, his play in the series was never in question. He batted .375 for the series, with a homerun, six runs batted in, and no fielding errors. Even more so, Jackson informed the White Sox owner, Charles Comiskey, that the bribe was on and asked for advice. Comiskey turned his back on Jackson.

The scandal deeply hurt America, and was compounded by the loss of one of its brightest stars. Jackson died on December 5, 1951 from a heart attack. His story has been retold many times, including in the movie *Eight Men Out*, which helped to spark a resurgence in a public push to see Jackson reinstated into the game, thus allowing him a place in Baseball's Hall of Fame.

#### DANNY ALMONTE

The belief that America's youth sporting leagues and associations were free from corruption ended

in the aftermath of the 2001 Little League World Series. Danny Almonte and the rest of the Rolando Paulino All-Stars burst onto the scene of the 2001 Little League World Series led by Almonte's dominating pitching. The team from the Bronx, New York City, finished third in the tournament and Almonte was crowned the game's brightest star. The young phenomenon threw a perfect game against Apolea, Florida, on August 18, with a fastball that reached 70 miles per hour. The team from the Bronx only lost when Almonte was not pitching. However, after the tournament finished, *Sports Illustrated* magazine revealed that Almonte's birth certificate had been forged, making the Dominican-born pitcher actually 14 years old. Little League rules strictly prohibit any child over the age of 12 from participating, thus the Rolando Paulino All-Stars were stripped of their Little League accomplishments, including their third place finish in the tournament.

This revelation shocked many people, since the media had glorified the team. Almonte's father, Felipe de Jesus Almonte, and the Bronx league's founder, Rolando Paulino, came under serious scrutiny. Paulino received a lifetime ban from Little League baseball. The elder Almonte was believed to have falsified his son's birth certificate and also received a lifetime ban. The team fell from grace as America was awakened to the fact that its most beloved sporting institutions were not safe from the tentacles of scandal that was thought to be far from the sacred grounds of Little League baseball.

#### THE BRONX BULL

One of boxing's toughest and fiercest middleweight fighters of all-time was Bronx native Giacobe "Jake" LaMotta. From 1949 to 1951, the Bronx Bull held the middleweight crown. Born on July 10, 1921, LaMotta was revered for his ability to absorb punches and for having a rock-hard chin that allowed him to constantly press his opponents. He was the first boxer to defeat the legendary Sugar Ray Robinson, winning in 1943. On June 16, 1949, he defeated Marcel Cerdan in Detroit, Michigan, to win the middleweight belt. His championship reigned until February 14, 1951, when Robinson defeated him in Chicago, Illinois, in a fight nicknamed the St. Valentine's Day Massacre.

LaMotta's career is as much remembered for his ability to withstand a punch as it was for his notori-

ous November 14 fight against Billy Fox in 1947. Fighting in New York City, LaMotta lost a fourth round technical knockout to Fox in which he took a dive to ensure that the weaker fighter would win. The incident was revealed in 1953, when LaMotta was called to testify in front of the Federal Bureau of Investigation, which was holding a series of investigations into local mafia affiliations. LaMotta freely admitted the fact that he took the dive, insisting that it was the only way in which he could gain a title shot at the middleweight crown.

Boxing has long been associated with gambling and bribes, and this was particularly prevalent in the 1940s and 1950s. A strong organized-crime influence gripped the sport, and in order for title shots to be granted, the mafia would have to approve them. LaMotta more than deserved a title shot based on his world ranking, but found himself unable to get the opportunity. He agreed to lose to Fox as a favor to the underworld chiefs in order to guarantee himself a title opportunity, which he received in 1949. LaMotta retired from boxing in 1954, then as a light heavyweight, with a career record of 83-19-4, with 30 knockouts. The trials and tribulations of his life were made into the 1981 movie classic, *Raging Bull*.

## OLYMPIC SCANDALS

While baseball scandals tend to have the most saddening affect on the American public, perhaps nothing can be as disgraceful as being caught cheating on the world's stage at the Olympics. In 1988, Canadian sprinter Ben Johnson felt first-hand the disgrace of being caught cheating in his sprint, the 100-meter dash.

With a star-studded line-up that included Olympic great and reigning gold medalist Carl Lewis, as well as future champion Linford Christie, Johnson blew his competition away by setting a world record time of 9.79. This beat his own world record, set a year earlier, of 9.83. However, doubts had been growing as to whether the muscular Johnson had been using steroids. Only two hours after his Olympic glory, Johnson was shocked to hear that he had failed a steroid drug test. His gold medal was stripped and awarded to Lewis, and his two world record times were erased from the record books. In 1993, he again tested positive for steroids and received a lifetime ban from track and field. He has since become a spokesperson for the problems

and dangers of drugs in sports, and claims that especially in track and field, performances enhancing illegal substances are common. In 1999, Christie received a two-year ban for testing positive for nandrolone. Even the great Lewis was not safe from drug controversy, as he has remained the subject of much debate as to whether or not he had tested positive for three banned substances prior to the 1988 games in South Korea.

The 1988 Summer Olympics was the scene of even more controversy than the 100-meter dash. In the boxing ring, American light middleweight Roy Jones, Jr. was the victim of corrupt boxing judges. Fighting for the gold medal against South Korean Park Si-Hun, Jones out-punched his overmatched opponent 86 to 32. His performance was so dominating that he was awarded the Val Barker Cup, an award given to the Olympics' best boxer. Yet, in a startling turn of events, at the conclusion of his match, the judges awarded the fight and thus the gold medal to the South Korean. Jones was left devastated, as were the live audience and viewers from home. Referee Aldo Leoni was equally as shocked by the result. Bitter justice was later served when it was revealed that South Korean businessmen had bribed the judges. While Jones was cheated out of his taste of Olympic glory, he left the Olympics and became one of the greatest pound-for-pound fighters of all-time, winning belts at the middleweight, super middleweight, light heavyweight, and heavyweight divisions.

## INTERNATIONAL SCANDALS

One of South Africa's most celebrated cricket players was born September 25, 1969. Wessel Johannes "Hansie" Cronje became South Africa's captain at age 25 and held this role until he was removed for alleged match-fixing in April 2000. In October 2000, he received a lifetime ban from cricket for admitting that he took money bribes from bookmakers over an unspecified period of years. He also admitted to asking his teammates to under-perform for money. Two of these players, Herschelle Gibbs and Henry Williams, received six-month cricket suspensions.

Cronje's problems became apparent when he was recorded talking with an Italian bookmaker. A self-proclaimed devout Christian, Cronje at first denied the allegations, but later admitted foul play. He claimed that his greed had consumed him, and



while he acknowledged taking bribe money, he denied match-fixing. On June 1, 2002, Cronje died in a plane crash at age 32. At the time, it was still not certain if he would face prosecution. Regardless of his acts, Cronje remained popular among his former teammates, who dedicated the 2003 Cricket World Cup, in South Africa, to their late captain. His popularity among South Africans remained divided, however, as for many, regardless of his skill and ability, Cronje violated the time-honored traditions of the sport.

## WORLD CUP

Two of the biggest soccer scandals that damaged the integrity of international football (or soccer) both involve the Argentinean national team. With one of the greatest international records, including three World Cup championships, the Argentines have been surrounded with their share of controversy. In 1978, a year that Argentina would go on to win the World Cup, the team faced an upward climb in order to reach the final group. At the time, the format for the World Cup had 16 teams in groups of four. Each team within a group played each other, and the two top teams in the group advanced to the second round. The second round consisted of two groups of four, and once again, each team would play each other within their group. The top two teams of each group would meet in the World Cup final. In case two teams finished with the same record in a group, goal difference was a deciding factor to break the tie.

Argentina advanced to the second round of the 1978 World Cup, and found itself in a group along with Peru, Brazil, and Poland. Argentina beat Poland by two goals, and then drew with Brazil. The Brazilians, meanwhile, beat Peru 3-0 and Poland 3-1, giving them a goal differential of 6 goals to 1. Argentina against Peru was the last game of the group, and the Argentines knew beforehand that in order to reach the finals, they would have to beat Peru by at least 4 goals. When the final whistle blew, Argentina had won 6-0 which allowed them to advance to the final. However, immediately following the game, it was widely speculated that Peru had been bribed. Their goalkeeper, who played one of the worst matches of any goalkeeper, denied having thrown the game. The problem with his denial is that he made it prior to anyone accusing him of being bribed. Argentina went on to defeat Holland

in the finals, in what in all likelihood should have been Brazil against Holland. For Peru, however, it was rumored that the Argentine military placed \$50 million in a trust account for Peruvian players, their families, and soccer officials.

Sixteen years after the Peru incident, Argentina's biggest star was disgracefully sent home from the 1994 World Cup. Diego Maradona was without question one of the greatest soccer stars to ever grace the pitch. Born October 30, 1960, in Buenos Aires, Argentina, Maradona led his country to glory by winning the 1986 World Cup, in which he distinguished himself as the premier player of his era. He also found much success in both the Italian League and Spanish League, winning league titles for Barcelona (Spain) in 1982 and for Napoli (Italy) in 1987 and 1989. Known as much for his dazzling dribbling skills as well as his sometimes volatile temper and grandiose arrogance, Maradona's brilliant career soured as he was twice suspended for failing drug tests.

His first suspension was issued in 1991 and kept the superstar away from the game for 15 months. A surprising comeback in the 1994 World Cup witnessed a revitalized Maradona fall victim to a second failed drug test after he tested positive for the enhancing stimulant ephedrine. He was again banned for 15 months, effectively ending his soccer career. Amid all of his turmoil, including a battle with cocaine, Maradona remained one of the most popular figures to soccer fans worldwide.

## SEE ALSO

organized crime; bribery; corruption.

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## Standard Oil

IN 1859, WITH \$1,000 in savings and a \$1,000 loan from his father, Cleveland, Ohio, resident John D. Rockefeller formed a partnership with Maurice B. Clark and became a commission merchant, a go-between who received a percentage of commission on each sale. During the Civil War, Rockefeller prospered from the generous prices the U.S. government paid him, and he used the profits from that business as well as credit to finance his entry into the oil business. In 1863, Rockefeller and his partners founded Rockefeller, Andrew & Flagler. When the partnership split, Rockefeller and Andrews bought out the other partners (by then, three) for \$72,500.

By 1868 this oil-refining business was the world's largest, and in 1870 Rockefeller created Standard Oil Company of Ohio, capitalized at \$1 million, which began integrating horizontally by buying out the competition, consolidating all oil refining into Standard Oil. Eight years later, the company owned approximately 90 percent of the United States' oil-refining capacity.

Standard bought virtually all the refineries in Cleveland as well as two in New York City. It established its own barrel-making shop to handle the 29,000 barrels of crude it produced each day. It built storage tanks capable of holding several hundred thousand barrels, warehouses for its refined product, and facilities for the manufacture of finished products such as glue and paint. In 1882, Standard consolidated all the businesses into the Standard Oil Trust, capitalized at \$70 million, with 42 owners. The next step was to control the entire business through vertical integration, from the well to the kerosene lantern that used much of Standard's oil.

When the Ohio courts dissolved the company after a decade, the companies of the trust formed Standard Oil Company of New Jersey, taking advantage of state law that allowed holding companies, parent companies that held stock in other companies. Although divested of some of its holdings, Standard retained a petroleum market share of 75 percent.

Standard Oil engaged in dubious business practices. Its cutthroat methods and favored treatment in deals with the railroads allowed it to undercut competitors, eventually expanding its control of refining into a stranglehold on the pre-Spindletop oil business. Standard monopolized resources to the

extent of buying all components needed for barrels to prevent the competition from making the barrels that they needed to market their products. Rockefeller also undercut the prices of smaller companies, taking a short term loss until the smaller companies either sold out to Standard or went out of business. The company also coerced rebates from railroads by threatening to take its immense business elsewhere. When all else failed, Rockefeller hired goons to break up uncooperative operators' businesses. Standard also opposed organized labor.

### UNREASONABLE MONOPOLY

These practices created enemies, an unfavorable reputation, and an incentive for antitrust authorities to act. Legal action in the 1880s proved futile. In 1890, largely in response to Standard Oil, Congress enacted the Sherman Antitrust Act, which outlawed all combinations in restraint of trade. In 1892, the attorney general of Ohio brought an antitrust suit against the company based on Sherman. In 1911, the U.S. Supreme Court ruled that Standard was an unreasonable monopoly in violation of the Sherman Antitrust Act, forcing Standard to break into a cluster of companies. The owners of Standard remained owners of the fragments.

The Supreme Court had dissolved a trust for the first time, sending notice that there would be at least occasional enforcement of the Sherman Act, but it also modified the act by ruling that only "unreasonable" restraints—whether combinations and contracts—were antitrust violations. Before then, the law had provided that "all" restraints of trade were illegal. The concept enunciated by Justice Edward White was known as the rule of reason.

### SEE ALSO

antitrust; Sherman Antitrust Act; Rockefeller, John D.; robber barons; predatory practices.

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JOHN H. BARNHILL, Ph.D.  
INDEPENDENT SCHOLAR

## Stanford, Leland, Sr. (1824–1893)

LELAND STANFORD, Sr., was born on the family farm at Watervliet, New York. He studied law, and was admitted to practice in 1848. He moved to Port Washington, Wisconsin, the same year, where he entered into legal practice and where he met and married his wife, Jane, the daughter of a wealthy businessman.

In 1852 he moved to Cold Springs, California, where he became involved in his brothers' mercantile business. In 1855, Stanford moved to Sacramento, California, to pursue other business interests—and he developed an interest in politics. Stanford served as California governor from 1861 to 1863, and later as a Republican U.S. Senator from 1885 until his death in 1893.

While living in California, Stanford became acquainted with fellow businessmen Collis P. Huntington, Mark Hopkins, and Charles Crocker, all of whom would come to be called robber barons, along with men like Jay Gould and Cornelius Vanderbilt. Together they created a venture called Pacific Associates, which looked for mutually beneficial business opportunities. Through Pacific Associates, Stanford and his business partners built the Central Pacific Railroad and later, the Southern Pacific Railroad. Stanford was named president of the Central Pacific Railroad in 1863.

The goal of the Southern Pacific Railroad was to complete the transcontinental link with the Union Pacific Railroad, which was achieved in 1869 at Promontory, Utah. The four Pacific Associates partners invested \$200,000 in the venture, but depended on government grants and bond guarantees for most of their funding. Within a short time after the completion of the Central Pacific Railroad, the partners became extremely wealthy, purchasing vast acres of land, lumber, vineyards, and mining properties and interests.

This was possible because they had a monopoly on railroad transportation of goods and passengers from the West Coast to the midwest. Before the rail-

road, the only means of long-distance travel was via horses or ships—neither of which moved very quickly. The railroad allowed for relatively rapid transportation, but at great cost. Passengers paid 10 cents per mile traveled, and freight was hauled at exorbitant prices.

As a result of the monopoly, farmers and ranchers who wanted to sell their goods in the eastern part of the country had to pay whatever freight prices were set by the railroad. This monopoly also benefited the partners when building the Southern Pacific Railroad to southern California.

During this process, they demanded that local cities and counties pay the cost of construction if they wanted the rail line to run through their areas. Failure to pay the ransom resulted in the railroad being built around those cities and counties. Community leaders knew that reliable transportation was vital to economic growth, so they paid the bill. Stanford's political acumen was also useful in influencing regulation of the railroads. In 1881, the California legislature created a three-member railroad commission to regulate shipping tariffs in the state. Stanford and Huntington were permitted to name two of the members, thus guaranteeing support for their monopoly.

### SEE ALSO

robber barons; monopoly; reform and regulation; antitrust.

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LAWRENCE M. SALINGER  
GENERAL EDITOR

## Stavisky, Serge (1886–1934)

SERGE Stavisky (also known as Serge Alexander) was a French confidence man of diverse talents. His criminal activities spanned decades and culminated in a notorious political scandal known as the Stavisky Affair. This event triggered the downfall of

Camille Chautemps' government in 1934 and had long-term repercussions for the political stability of France.

Stavisky's family left the Ukraine for France in 1899. His aptitude for deceit emerged when he was in his early teens. Stavisky refined and tested his skills to prey on the confidence and trust of others by creating illusory business ventures and soliciting capital investment from friends and clients. It was a recurrent theme throughout his life—profit through misrepresentation.

Stavisky's criminal enterprises took him and his partners into the worlds of entertainment, journalism, mass marketing, politics, finance, and invariably—criminal justice. In 1925, Stavisky and Henri Hayotte formed a company, Le P'tit Pot, that promoted and sold a meat-based bouillon. The pair sold this fictitious product to merchants and retailers, realizing a sizable profit in doing so. Although he fled, Stavisky was eventually captured and served a three-month sentence in prison.

On release, Stavisky conducted many fraudulent activities. These included forging stock certificates and checks, impersonating a stockbroker, counterfeiting, selling a device known as the Martyscope for detecting pregnancy, bilking cafes and theaters of receipts, bouncing checks, issuing bonds without capital, pawning counterfeit jewelry, and promoting variations of the Ponzi scheme. The regulatory and bureaucratic disorder of post-World War I France created a climate vulnerable to exploitative individuals like Stavisky. The absence, moreover, of effective oversight in the banking and finance industries aggravated the problem of enforcing commercial codes of conduct.

Stavisky's most significant fraud, however, began in 1928. Stavisky created Etablissements Alex, a municipal pawnshop, in Orleans. He circulated counterfeit jewels through the pawnshop, financing credit for the items by issuing bonds. Such businesses were only allowed to issue bonds equal to their assets. Stavisky sold million of francs in bonds using bogus jewelry as collateral. When the bonds came due for redemption Stavisky set up an identical firm in Bayonne in 1931, sold bonds, and used the revenues to partially pay back the debts owed in Orleans. He used his substantial profits to buy influence among journalists, the business communities, politicians, and the legal systems. People trusted Stavisky, and advocated on his behalf. Creditors eventually closed in on Stavisky. He could not

cover his old debts with new bonds. A compulsive gambler and lavish spender, Stavisky fled criminal and civil charges. On January 8, 1934 in Chamonix, Switzerland, minutes before the police were about to break down his door, Stavisky shot himself (some sources suspect the police had a hand in his death).

The subsequent trials (1935–36) of Stavisky's accomplices uncovered corrupt relationships within government and business. Lax enforcement of the law and official indifference to Stavisky's many duplicitous enterprises drew public outrage and challenged the legitimacy of the Third Republic of France. The Stavisky Affair exposed and discredited the radical Socialist Party and undermined public support for parliamentary government.

#### SEE ALSO

Ponzi schemes; scams; bond fraud; France.

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JOSEPH LINCOLN Steffens was an American author and editor, and one of the first and leading muckrakers. In 1906, President Theodore Roosevelt referred to a group of journalists as muckrakers, liking them to a *Pilgrim's Progress* character in the novel who was only interested in raking muck or dung. These muckrakers exposed corruption, abuse of power, and the suffering of the nation's very poor, and in doing so "provided American journalism with what many regard as one of its finest hours," according to an article by Stephen Goode.

Steffens began reporting in 1892 for New York City's *Evening Post*, then moved to an editorial position at the *Commercial Advertiser*, but continued to write freelance stories for magazines such as *McClure's*. Steffens was hired in 1901 to be editor of *McClure's*, but only held that position a few months

before the magazine's owner sent him to St. Louis, Missouri, to investigate tales of corruption in city government. "When I set out to describe the corrupt systems of certain typical cities," Steffens wrote in 1903, "I meant to show simply how the people were deceived and betrayed. But in the very first study—St. Louis—the startling truth lay bare that corruption was not merely political; it was financial, commercial, social; the ramifications of boodle were so complex, various and far-reaching, that one mind could hardly grasp them, and not even Joseph W. Folk, the tireless prosecutor, could follow them all."

#### THE MUCKRAKING ERA

The writer's findings of wrongdoing in St. Louis were published in *McClure's* in October 1902, the beginning of the muckraking era. A series of articles on Chicago, Minneapolis, Pittsburgh, Philadelphia, and New York City followed. These articles were collected in Steffens' book *The Shame of the Cities* (1904). Subsequent investigations into state and federal government led to more exposé articles and *The Struggle for Self-Government* (1906), and *Upbuilders* (1909).

Unlike some muckrakers who preferred to write about previously unknown wrongs, Steffens emphasized the fact that most government corruption was known and allowed by its constituency. The writer also offered suggestions for reform, rather than just reporting evils. Disappointed that he had not made a difference, Steffens was ready to stop muckraking journalism about the time the style died out around 1911.

Steffens began to lecture on muckraking and politics, and after the death of his wife he traveled widely, including three trips to the Soviet Union between 1917 and 1923. The writer lectured enthusiastically about post-revolutionary Russian life and the Russian system of government. This fostered popular and critical disapproval of his work, but he was selected to be part of a 1919 American-British secret fact-finding mission talking to the Bolsheviks and Soviet leader Vladimir Lenin. It was following this visit to Russia that Steffens uttered, "I have been over into the future, and it works," which later became the oft-quoted, "I have seen the future, and it works."

In 1924, Steffens married his second wife Ella Winter, with whom he had a son. Because most

men his age were grandfathers when he was just becoming a father and he believed he would probably not live to see his son become an adult, Steffens began his *Autobiography*, an immediate bestseller. He died 12 years later.

#### SEE ALSO

Roosevelt, Theodore; corruption; Sinclair, Upton.

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LINDA M. CREIBAUM  
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## Stewart, Martha (1941–)

MARTHA KOSTYRA was born and reared in a working-class family in New Jersey. Her mother, a schoolteacher, and her father, a pharmaceutical salesman, held high standards and expectations for their children: ambition, achievement, and perfection were instilled at an early age. Martha, who married and eventually divorced Andrew Stewart, began her successful career as a model and then stockbroker. After leaving Wall Street, Stewart moved to Westport, Connecticut, and began restoration of an 1805 farmhouse that later served as the backdrop for her television appearances and programs.

Within 10 years, her catering business and specialty retail shop became a \$1 million enterprise. Her first book, *Entertaining*, was published in 1982 and her merchandising collaboration with Kmart made Martha Stewart a household name that represented the American Dream and the embodiment of a prosperous homemaker-entrepreneur. She was chief executive officer of Martha Stewart Living Omnimedia, and in 1999, when the company became public, she was worth over \$1 billion.

Her stalwart image was scorched, however, when accusations of insider-trading emerged. The investigation focused on Stewart's sale of ImClone stock. In 2001, two days after Christmas while on a Mexican vacation, Stewart called her Merrill Lynch

stockbroker, Peter Bacanovic, and requested that he sell her 3,928 shares—a move that made her less than \$230,000. Samuel Waksal, chief executive of the biotechnology company and friend of Stewart, had just dumped millions of dollars of shares based on information that the Food and Drug Administration (FDA) would deny approval of the company's highly anticipated cancer drug.

After his arrest, Waksal pleaded guilty to insider trading and was sentenced to seven years in prison and \$4 million in fines and restitution. After a year-long investigation, Stewart was indicted, not for the alleged crime, but for the cover-up. The U.S. attorney admitted being unable to prove that she knew of the pending FDA announcement and thus had engaged in insider trading. The 40-page, nine-count indictment accused her and Bacanovic of obstruction of justice, conspiracy, making false statements to the government, and securities fraud. In her defense, Stewart maintained that she had prearranged a stop-loss order to sell the ImClone stock if the price dropped below \$60 a share.

Stewart was found guilty of lying to cover up the stock deal but not guilty of the securities fraud charge. In a remarkable turn of life events, the “doyenne of domesticity” who had reached such heights, was now looking at possible jail time.

#### SEE ALSO

insider trading; securities fraud.

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## stock churning

STOCK CHURNING IS THE excessive trading of securities in a brokerage account. Also called burning and churning and over-trading, churning is done in order to increase the broker's commissions, which are directly related to the volume of trading

rather than customer profits. Part, or sometimes all, of the client's potential profit may be absorbed by the broker's commission on some trades even though there would otherwise seem to be a profit. Sometimes, the commission will result in the client actually taking a loss on what would have been a profitable trade. In these cases, the broker makes a profit but the client would have been better off with an unchanged portfolio. Although some changes are necessary or good business for the client, excessive trading or churning is good business only for the financial adviser and her firm.

According to PR Newswire, churning is involved if these conditions are met: “The trading in the customer's account was excessive in the light of the customer's investment objectives; the broker exercised control over the trading in the account; the broker intended to defraud or demonstrated willful and reckless disregard for the customer's interest.”

Over-trading is not solely within the realm of stockbrokers. Because the charge, or load, to a client on a mutual fund is typically higher than it is on stock sales, fund advisers can make larger commissions by moving an investor's holdings less often than with stocks. There are several forms this deceit can take.

Mutual fund managers sometimes churn the portfolio of stock holdings within their funds, sometimes on a daily basis. If the fund manager simply exchanges one of a client's funds with a similar one, he reaps the commission but the portfolio's performance does not change significantly. Because the performance is unchanged, the owner might not notice the change, but her value or interest has been lessened or depleted by the manager's commission on the trade.

Another kind of mutual fund churning occurs when a fund manager switches from one kind of fund to another, such as a mutual fund to a unit investment trust then to another mutual fund. Sponsors or families of investment vehicles will usually allow investors to shift money between funds within their group with no commission charge, so if a change is desired or necessary, staying within the same sponsor or family can be beneficial to the fund holder without costing him a commission on the change. Unscrupulous brokers will exchange sponsors simply to get a commission.

A side effect of churning is that it can be problematic for companies whose shares are traded often. Long-term stock holders may provide a com-

pany with more stability and options for long-term planning and profits than having a majority of short-term investors.

Although high trading volume is typical of churning or overtrading, all relatively high turnover is not necessarily a concerted effort by a broker or manager to increase commissions. An investment house basing buy and sell decisions on short-term technical and liquidity indicators will have higher turnover than a house with the “buy and hold” approach. Some decisions are also based on an exceptional offer to buy or to sell or other valid investment reasons.

Most brokers and fund managers are honest, but there is much pressure for production performance. Along with greed (broker income is based on commissions and bonuses), motives for churning include performance pressures from within the securities industry and sometimes the firm itself. Unsuccessful individuals will not continue in this line of work very long.

Some of the precautions stock or fund holders can take in preventing or avoiding being taken advantage of by churning include being cautious of pressure to invest or make changes quickly; carefully examining account statements and questioning anything that seems suspicious or unclear (although commissions are not always separated out in fund statements); being suspicious of guarantees in performance or earnings.

Mutual funds are typically considered to be long-term vehicles, so frequent changes of a client's holdings from one fund to another, or one kind to another, might prove to be a red flag to investors. One of the most important steps is to know your broker. The National Association of Securities Dealers (NASD) will provide the full disciplinary record of any broker.

In the United States, churning may have both civil and criminal repercussions, and is under the jurisdiction of states' blue sky laws and the Securities and Exchange Commission (SEC). Brokers convicted of churning can lose their licenses, be required to pay restitution, and/or be incarcerated.

#### SEE ALSO

stock fraud; securities fraud; National Association of Securities Dealers; Securities and Exchange Commission.

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## stock fraud

THE TOPIC OF STOCK fraud were prominently featured in the news media through the 1980s, 1990s, and the beginning of the 21st century. Names like Enron became part of the lexicon, while the terms *penny stocks* and *boiler room* made their way into the public conscience and into Hollywood productions. Because of these events, the public's confidence in the stock markets was predictably affected. Politicians and other public officials have scrambled to devise ways to avoid such large-scale frauds in the future.

Though the term *stock fraud* can encompass numerous illicit activities, there are essentially two key types of stock fraud—insider trading and market manipulation (each with many variants that can fill volumes unto themselves). Unfortunately, there are no valid statistics available to compare the difference in prevalence and significance of these types of stock fraud.

### EARLY FRAUDS

Historically, documented stock frauds in the United States date back to the 1800s. These frauds included the gold and silver mines of the American west, in particular the Colorado gold rush in the 1880s. Prospectors had little capital and turned to selling shares to finance their ventures. Those unable to lure more substantial investments sold shares for as little as a penny. Of course, many “prospectors” were nothing of the sort, and frauds were commonplace.

On the heels of the 19th century miners came the oil and gas promoters. By 1918, towns like Fort Worth, Texas, were home to motley armies of “lease sharks, grafters and grabbers, operators, speculators, and gamblers,” according to authors Roger

M. Olien and Diana Davids Olien. In Los Angeles, California, the Department of Justice estimated that stock swindlers hawking oil securities, many for little more than \$1, were making about \$100,000 a week in 1923. The activities leading up to, and including, the stock market crash of 1929 resulted in the Securities Act of 1933, which requires companies going public to register their securities offerings and to supply financial and other material information enabling investors to make informed decisions. The Securities Exchange Act of 1934 followed, creating the Securities and Exchange Commission (SEC) as the primary agency responsible for administering federal securities laws. These measures were intended to restore confidence in securities trading, and have remained the hallmark of regulation and enforcement.

The topic of stock fraud lay dormant, with minor exceptions, until the infamous insider trading cases of the 1980s. These scandals were serious enough to result in the U.S. Senate Committee on Banking, Housing, and Urban Affairs inquiry, "Improper Activities in the Securities Industry." Following the insider trading cases of the 1980s and before the high-profile Enron, Tyco et al. cases the early 2000s, the most commonly discussed frauds were concentrated in the "micro-cap" market, more commonly referred to as the penny-stock industry.

## PENNY STOCKS

The U.S. penny-stock market was designed as a "conduit through which money from small investors travels to legitimate young companies in need of venture financing," according to Robert L. Frick and Mary Lynne Vellinga. There is no commonly held definition for penny stocks. In general, penny stocks are considered those securities not listed on a recognized exchange, hence they are traded over-the-counter (OTC), and information about them is only available on the "pink sheets." Some argue, however, penny stocks are those that trade for less than \$5.00 per share, and thus can be found on NASDAQ exchange. While there are several types of securities violations (for example, failure to disclose, unauthorized trading, refusal to execute orders, etc.), market manipulation dominates penny-stock fraud.

Until the mid-1980s, criminal penny-stock firms made their money through initial public offerings (IPOs) of phony and/or overvalued securities

(that is, the primary market). The North American Securities Administrators Association (NASAA) noted that criminals then shifted their emphasis "from the primary market of IPOs to the secondary or 'after' market." This was done through the much greater use of what are called blank check blind pools. Stock swindlers tweaked the concept and began conning investors to give them money for investments in unspecified companies. They were asking for what came to be known as a blank check. The blind pool typically stands for a sham corporation which has been created to "merge with other closely-held public companies in order to bypass federal and state securities regulation, gain immediate access to the secondary market and serve as a vehicle for market manipulation," NASAA explains.

Diane Francis describes blind pools as "venture capital outfits" that raise money without needing to tell the investors there was a specific plan in mind for use of their money. One of the most audacious blind pool shams in history was Canada's infamous Bre-X mining scandal, which ran from 1993 to 1997, and involved a Busang, Indonesia, site that failed to produce the expected gold. The stock tumbled from C\$28.50 to \$.00005 per share, and cost Bre-X's chief geologist his life when he "fell" out of a helicopter over the rain forest in Samarinda, Indonesia.

## SCALPING

The secondary market became the arena for making really big money. Generally speaking, it works like this: a public offering is made for the stock of a sham company, which is merging with another usually unspecified firm already registered with the SEC. Investors are not informed, of course, that the swindler's firm owns the bulk of the shares. (This practice is known as scalping and is a violation of the Investment Advisors Act of 1940.)

The price is then driven up, made all the easier when the crooked firm is the sole market maker. At some predetermined peak, the swindlers sell their shares in this new firm, the product of the merger, in what is called the secondary market. For the insiders to hit the peak and get out, the investing public cannot be allowed to sell their shares. The criminal firm simply refuses to execute sell orders on behalf of its clients. The firm's sales representatives, who do the scripted telephoning to hook the unwary, are ordered to either hang up when a client





*Stock fraud was mainly the province of “boiler room” operations until the advent, in the 1980s and 1990s, of top Wall Street firms involved in corporate malfeasance and accounting fraud.*

calls who wants to sell, or not to answer the phone during “selling” times.

Blank checks and blind pools rely on the most important technical innovation the criminal stock firm has—the telephone, which by the 1980s evolved to include toll-free numbers, call waiting, call screening, the availability of specialized phone lists, and interacted with fax machines and computers. Their methods reveal the kinship between the penny-stock racket and the classic swindler’s boiler room operation: high-pressure promotion by telephone of a bogus commodity, often by people who don’t have the foggiest idea what it is they are promoting. Perhaps Lorenzo Formato, a high school dropout, represents the best example. Formato started out on the telephone with Mayflower Securities, the progenitor of some of the most important penny-stock criminals in U.S. history.

Though completely ignorant of the brokerage business, he had more clients than anyone else at Mayflower within six months. He didn’t know what stocks were, but he did know that selling them could make him a lot of money. He sold and sold “never knowing,” he told the U.S. House of Representatives, “whether or not the stock was any good,

whether or not the company had any profits, whether or not the company even existed.” Boiler rooms may operate out of homes, warehouses and any number of places, but they are most often operated in offices. Salespeople sit at desks cold-calling potential investors, typically reading off of a script.

#### THE RATIONAL INVESTOR

In the world of securities, there are several third parties, including private associations of securities dealers at the state and national level, state government regulators, and the SEC, whose work is based on creating sufficient rules to compel broker-dealers to give true disclosure, thereby creating trust between sellers and buyers of securities. Underlying this is the concept of the rational investor. That is, there simply cannot be a rational investor without honest and full disclosure, though no one guarantees the rational investor will be successful and no one knows whether the informed investor is more likely to succeed than the intuitive investor.

What the SEC does is to try and reduce the risks or level the playing field of what is always, essentially a gamble. One of the basic tenets of regu-

latory agencies is that consumer education is the key to reducing crimes by society's elite. This is particularly the case with securities fraud in the United States, because the SEC and National Association of Securities Dealers (NASD) structure their policies around the "informed," "educated," or "rational" investor paradigm. With the advent of the internet, and the related resources for prospective investors, there has never been a better time for investors gathering information on stocks, firms, shareholders, employees, and other relevant data. And yet, concurrent with the rise in these resources for investors came the explosion in penny-stock fraud, dispelling the notion of the informed investor. If disclosure and investor education have each been stressed without success, what are the other possible remedies?

## SEC REGULATION

Susan Shapiro (1984), in her classic study of the SEC, notes that SEC commissioners have three formal legal options in pursuing cases against perpetrators of a particular offense: civil proceedings, administrative proceedings, and referrals to the U.S. Department of Justice. She found that 93 percent of suspects investigated by the SEC have committed securities violations that carry criminal penalties. As Shapiro and many others have noted, the SEC is far more likely to seek civil and administrative proceedings than to seek criminal prosecution. The NASD, similarly, may refer cases involving criminal activity for further investigation and possible indictment, but they are also far more likely to seek civil remedies.

In Shapiro's study, she found that only 46 percent of the total number of cases referred to the Department of Justice for criminal prosecutions resulted in convictions. These findings go a long way to explaining the persistent pattern of utilizing civil and administrative proceedings by regulatory and law enforcement agencies. These proceedings are usually settled when the defendant consents to some penalty, fine, suspension, etc., "without admitting or denying the facts, findings or conclusions contained" in the "offer of settlement," commonly referred to as a consent decree.

Ironically, it was the "Johnny Appleseed of massive penny-stock fraud," Robert E. Brennan, who thought SEC consent decrees meant little in practice. He said that in a consent decree, the SEC

proves "nothing, I admit nothing, and they can go tell their bosses in Washington, D.C., they've done a good job." He added, "It's a disgrace."

Studies have frequently identified several reasons that authorities give in defending their preference for non-criminal proceedings. The most common reasons cited are the following: the lower legal threshold in civil cases that enables easier prosecution; the higher likelihood in civil cases that defendants will cooperate to avoid the criminal justice system, and the ensuing labeling, which is advantageous for regulators because it expedites the process and frequently serves as a means of intelligence-gathering to thwart future offenses.

Moreover, there is the prospect for substantial fines in civil proceedings. Thus, while there is general agreement that civil and administrative proceedings are ineffective as a deterrent, there are practical reasons government officials elect these processes. Consider the following exchange between U.S. Senator Max Cleland and Securities and Exchange Commission Chairman Arthur Levitt, Jr.:

Senator Cleland: I understand the importance of injunctions and consent decrees and receivers and trustees and other types of administrative and civil sanctions that can be applied against violators. The media is full of stories about the major frauds perpetrated on our citizens. It is my opinion that the only sanction, quite frankly... that most of the serious violators will understand as a successful deterrence is jail time and the completion of a successful criminal prosecution. Do you have any idea why more of the major fraud cases do not end up in the criminal courts?

SEC Chairman Levitt: Well, I think it is a question of calendars that are so full and commitments that are so great, and these are cases that are difficult cases to bring and to prove. It is only in the most egregious cases that we get to criminal actions. We find that there are very few districts of our Federal courts that are experienced at bringing securities cases. Some of them, such as New York and California, do have that experience and recognize it as a major area for their involvement. Others simply would rather go after bank robbers than they would go through the difficult process of trying to prove what a securities fraud is.

Research has documented the omnipresence of fraud in the stock-market industry since its inception, and media outlets have covered both individual cases and industry-wide activities. No less an authority than Attorney General Robert F. Kennedy wrote in 1964:

A highly profitable activity for racketeers with legitimate business interests has been stock fraud. Often, rackets figures with considerable at their disposal invest, not only in legitimate securities, but also in questionable stock. Typically, they artificially raise the price of such stock with calculated purchases and then sell large amounts through "boiler room" telephone solicitation. In one case, a leading Eastern rackets figure is now under indictment for evading taxes on more than a million dollars' profit received from sale of such stock.

With the skyrocketing of the securities markets in the 1990s, and with the advent of information technologies, the opportunities for, and actual occurrences of securities fraud came to the public's

awareness. The precipitous increase in legitimate stocks drew many uninformed investors into the fold. Thus, stock scammers no longer had to convince prospective "marks" they should invest, since the marks were themselves seeking investment opportunities. In 1999, NASAA President Peter Hildreth stated, "Today we have an ideal climate for fraud. Millions of new investors, many of whom expect unrealistically high returns, are looking for places to put their money. At the same time, we're living through an internet-driven technology revolution that is a boom to investors and con artists alike." Just as regulators were beginning to reign in penny-stock kingpins such as Randolph Pace, Meyer Blinder, and Robert Brennan, they soon became consumed with investigations of worldwide significance. Enron, Worldcom and others soon gained notoriety for their securities discretions, among other noteworthy issues.

As a response to corporate scandals born in the 1990s and early 2000s, the U.S. Congress drafted reform legislation titled the Sarbanes-Oxley Act of 2002. The act created a series of oversight measures, and expanded and increased the sanctions for illicit



*For fraudsters and investors alike, the information technology revolution has opened up new opportunities for research and education, or for stock fraud and scams, depending on the objective.*

white-collar actions, including stock frauds. President George W. Bush signed the legislation into law on July 30, 2002, and the U.S. Sentencing Commission approved lengthening sentences for stock fraudsters on January 8, 2003. Federal law enforcement agencies, most notably the Federal Bureau of Investigation (FBI), were consumed with terrorism investigations in addition to their normal mandates and responsibilities (organized crime and narcotics trafficking cases). Nevertheless, due in part to the activities enumerated above, the president of the NASAA stated that accounting and stock frauds "have become the hot, sexy cases ... I think a lot of people have changed their focus in terms of how seriously they're taking these cases." According to officials, cases that would normally have been handled exclusively by the SEC now routinely involve federal prosecutors and the FBI.

## HEIGHTS OF CORPORATE CRIME

On April 28, 2003, headlines in the United States announced the record settlement between the nation's largest investment firms and the SEC. Ten Wall Street firms settled civil claims for a total of \$1.4 billion to end several probes involving various frauds and conflicts of interest. The government used internal e-mails to illustrate how the investment firms touted stocks they knew to be of questionable quality, so their firms could gain investment-banking business.

For instance, one prolific stock analyst at Salomon Smith Barney, Jack B. Grubman, privately called one of the stocks he was publicly recommending a "pig." Another broker at the firm called Grubman a "poster child for conspicuous conflicts of interest." The apparent assault on corporate crime, particularly concerning stock fraud, continued in the summer of 2003. On July 25, the SEC announced a major strategic initiative concerning their primary remedy, consent decrees. Even in cases where the accused "neither admit nor deny wrongdoing," the agency will view defendants as having admitted the facts in the settlement.

Thus, a brokerage that agrees to a court injunction against committing fraud, even if it does not admit to fraud, may not contest the facts in future actions brought by the SEC in connection with the injunction. The "non-denial" denials have thus seen their last days. The new policy will likely make it easier for the SEC to follow injunctions with disci-

plinary actions. Some questions remain, however; first among them is whether the policy will reduce the number of settlements with the SEC. If so, this would create a problem seemingly ameliorated by the former policy of settlements, namely rising (and likely unmanageable) workloads for SEC investigators that ultimately serve to lessen the deterrent effect on violators.

## SEE ALSO

Securities and Exchange Commission; accounting fraud; securities fraud; Enron Corporation; WorldCom; Sarbanes-Oxley Act; Bre-X.

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## Sumitomo Corporation

THE SUMITOMO CORPORATION is a large Japanese company with interests in a wide range of fields. Like many other Japanese companies, Sumitomo has suffered from the effects of excessive diversification in the post-boom period and has subsequently been afflicted with various non-performing loans. In 2003, Sumitomo Mitsui, Japan's second biggest lender reported a loss of ¥465 billion (approximately \$3.9 billion) and was forced to seek additional funding. Some of its subsidiaries have been linked with poor environmental practices, for example, with respect to stockpiled pesticides which can pose a threat of toxicity.

However, a more startling revelation of corporate malpractice was revealed in 1996 when Yasuo Hamanaka, a trader at Sumitomo, was revealed to have cost the company some \$3 billion through losses in the copper market. Hamanaka had, with the apparent collusion of his former supervisor Saburo (Steve) Shimizu, been attempting to make money by cornering a portion of the copper commodity market. They had resorted to this illegal practice in 1985, supposedly to recoup through trading in futures on the London Metal Exchange (LME) money previously lost on physical trading deals.

Cornering the market involves purchasing a large amount of a commodity and then withholding it from sale for a period, thereby reducing the supply and hence inflating the demand and cost for it. By doing so, Hamanaka could make profits by selling the copper he had earlier obtained at a lower price. This practice can only succeed when it is kept secret and when sufficient quantities of the product are obtained to provide a meaningful level of control over market supply. Hamanaka was eventually unable to obtain these criteria for Sumitomo and was obliged to sell some of his product at a loss.

However, rather than accept the loss, Hamanaka attempted to manipulate the market further until his activities came to light and the market plunged into turmoil.

Hamanaka was subsequently jailed for eight years for his part in the deal, but Sumitomo, which brought a criminal complaint against Hamanaka in part to try to distance itself from allegations of its own wrongdoing, was not the only company to be implicated. In 1999, the brokerage house Merrill Lynch was accused of assisting Hamanaka's activities and fined £6.5 million (approximately \$10.4 million) by the LME and £9 million (approximately \$14.4 million) by the United States Commodity Trading Futures Commission.

Deutsche Bank, the leading German bank, through the actions of a subsidiary, was fined some £1.5 million (approximately \$2.4 million) by authorities for failing to exercise sufficient care in purchasing large quantities of copper for a client. As in the case of Nick Leeson at Barings Bank and other scandals, the Hamanaka affair revealed that the complexity of many modern financial transactions and inadequate supervision can lead individuals to believe their activities are undetectable.

### SEE ALSO

Yasuo Hamanaka; Leeson, Nick; Barings Bank; Japan.

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## Sutherland, Edwin H. (1893–1950)

CRIMINOLOGIST, TEACHER, and the person officially credited with the discovery of the white-collar criminal, on December 27, 1939, Edwin H. Sutherland coined the phrase in Philadelphia, Penn-

sylvania, in a speech he delivered as president of the American Sociological Society. The most often cited of Sutherland's various definitions of white-collar crime, from his 1949 monograph of the same name, conceptualizes it "approximately as a crime committed by a person of respectability and high social status in the course of his occupation."

Born in Gibbon, Nebraska, Sutherland was the fourth of five children of fundamentalist Baptist minister George Sutherland and Lizzie (Pickett) Sutherland. The family moved to Grand Island, Nebraska, in 1893, where Sutherland attended Grand Island College, played football, and graduated with an A.B. in 1904. In 1906, he began study at the pre-eminent department of sociology at the University of Chicago, the first such department in America (founded in 1890). He finished his Ph.D. in sociology and political economy in 1913. Sutherland taught at Sioux Falls College (1904-06), Grand Island College (1909-11), William Jewell College (1913-19), University of Illinois (1919-26), University of Minnesota (1926-29), and Indiana University (1935-50). He also worked as a researcher for the New York Bureau of Social Hygiene (1929-30) and the University of Chicago (1930-35). Sutherland is remembered as a self-critical scholar and a stimulating teacher.

## DIFFERENTIAL ASSOCIATION

Sutherland is best known for his theory of differential association, which focuses on learning from significant others the reasons for violating or not violating the law. Many of his ideas in differential association originated with the intense study of a professional thief, nicknamed Broadway Jones (*The Professional Thief*, 1937). His 1924 textbook, *Criminology*, had only rudimentary antecedents of differential association, but his third edition of the text in 1939 (*Principles of Criminology*) contained seven explicit propositions of the theory. These were expanded to nine in the 1947 edition, the last before his death. Differential association is the most enduring criminological theory of the 20th century, and Sutherland utilized the idea of white-collar crime as evidence for the validity of differential association.

Sutherland was the first to identify white-collar crime systematically, but he was not the first to write about it. He had the benefit of the muckrakers (such as Upton Sinclair and Ida Tarbell) and of

Matthew Josephson's 1934 publication of *The Robber Barons*. Sutherland was also exposed to the works of Charles R. Henderson, Edward Alsworth Ross, and Thorstein Veblen. Veblen's *Theory of the Leisure Class* (1912), for instance, likened captains of industry to typical juvenile delinquents. Sutherland was further anticipated by Albert Morris's "criminals of the upperworld" (1935), which included bankers, stockbrokers, manufacturers, politicians, contractors, and law enforcement officials as examples of the type.

Sutherland's 1939 speech, which was the culmination of his collected materials on white-collar crime over the previous 13 years, had three objectives. Sutherland wanted to emphasize that "white-collar criminality is real criminality" because it is in violation of law. Sutherland also reminded criminologists that poverty-based theories of crime causation—virtually all of the theories popular at that time—were intellectually inadequate because poverty did not differentiate between who committed crime and who did not. The third, and perhaps most important, purpose of Sutherland's speech was to assert that his theory of differential association constituted an approach that explained a general process characteristic of all criminality, including the social business influences that caused persons of high status to violate the law through occupation. It is interesting that Sutherland used white-collar crime primarily as the vehicle to promote differential association, rather than to spotlight white-collar crime.

In the decade that followed Sutherland's address, however, the question of whether his concept of white-collar crime actually dealt with real crime would become the subject of heated intellectual debate. Sutherland published "Is 'White-Collar Crime' Crime?" in 1945 in the *American Sociological Review*, which made more concrete his assertions about the criminal nature of the phenomenon. His main detractor was Paul Tappan, a legalistic sociologist who insisted that the term criminal can only be applied to persons convicted of an offense. Sutherland responded by stating that the penalties in both administrative codes and in penal codes are the same because they were designed by legislatures to invoke suffering for lawbreakers.

In his monograph, *White-Collar Crime*, published in 1949 shortly before his death, Sutherland presented 20 years of his research on the subject, having compiled hundreds of legal violations com-

mitted by 70 of the larger American corporations of his day. Sutherland tabulated all officially recorded violations against those organizations from their beginning through the time of his writing (organizational ages ranged from 18 to 150 years). Sutherland was aware of the shortcomings in his method: 1) there may have been violations about which he was unaware; 2) opportunities to commit crime vary with organizational size and age; 3) single adverse decisions sometimes involved large numbers of separate violations; and 4) the kinds of violations committed by organizations are closely related to their location in the economic system.

Sutherland used *White-Collar Crime* as proof for differential association and to announce that "white-collar crime is organized crime." It is organized primarily because white-collar (corporate) criminals manipulate the elections of officials and the focus of enforcement agencies. This represents an underlying anti-capitalistic theme in the monograph. In the original version of *White-Collar Crime* (1949), the names of the organizations were deleted, allegedly because, as Sutherland noted in the preface, "[a] theory of criminal behavior ... can be better attained without directing attention in an invidious manner to the behavior of particular corporations." Sutherland and his publisher were sensitive to libel suits. It was not until 34 years after its original publication that Sutherland's work reappeared in an expanded, "uncut" version that finally included the identities of the 70 corporations he had studied.

#### DEFINITIONAL PROBLEMS

Sutherland's inexact definition of white-collar crime has been seen as extremely problematic. It is difficult to study something that can not be well defined. Scholars have also pointed out that Sutherland's biggest theoretical problem was his tendency in *White-Collar Crime* to view organizations as the criminal actors, rather than the organizations' employees as the criminals. Differential association is explainable in terms of individuals' behaviors, not that of corporations.

Despite the flaws in *White-Collar Crime*, Sutherland succeeded convincingly in his main task—to reform the theory of criminal behavior through demonstrating that crime is abundant in the upper levels of society. He died of a stroke and an ensuing fall while walking to work at Indiana University on

October 11, 1950. At the time of his death, Sutherland had produced more than 50 academic publications in addition to seven books, and his writings on white-collar crime have been considered among the most influential works in the discipline. The Sutherland Award, bestowed annually by the American Society of Criminology, is the most prestigious recognition for an American criminologist.

#### SEE ALSO

differential association; self-control theory; Sutherland-Tappan Debate; techniques of neutralization.

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## Sutherland-Tappan Debate

MOST ASTUTE STUDENTS of criminology, particularly those interested in the topic of white-collar crime, are quite familiar with Edwin Sutherland's famous definition of the term: "a crime committed by a person of respectability and high social status in the course of his occupation." In focusing on white-collar crime as an area of research, Sutherland's main interest was in critiquing existing criminological theories. At this time, the main theories, such as social disorganization theory, sought to explain crime as a result of various structural factors, including poverty and inequality.

As Sutherland correctly argued, existing theories could easily explain violent, or common crimes committed by unemployed, street criminals. However, factors such as poverty could not accurately explain the criminal activities of educated, higher status individuals working in legitimate organizations. Sutherland's well-known definition of white-collar crime can be considered offender-based,

since it includes characteristics of the individual offender. However, Sutherland later suggested an alternative, offense-based definition, which broadly defined all white-collar offenses as violations of trust. Although Sutherland's early definitions of white-collar crime focused on individuals, he created further conceptual confusion when his landmark study of white-collar crime actually dealt with sanctions against entire organizations.

Regardless of whether he was interested in individuals or corporations, what is clear is that Sutherland was satisfied to consider white-collar crime behaviors that were punishable by law. Even if such offenses did not result in actual punishment, Sutherland felt they were still white-collar crime. He also did not believe it was not necessary to differentiate between criminal and civil statutes. All that mattered, according to Sutherland, was that some violation of a statute or code was taking place within the organizational setting.

Sociologist Paul W. Tappan, who also had legal training, took offense at Sutherland's position that acts were "crimes" and individuals were "criminals" if they had not been formally charged and adjudicated within the justice system. In particular, Tappan argued that Sutherland was attacking the integrity of the business world by labeling corporations as "white-collar criminals." Contrary to Sutherland, Tappan suggested in his 1947 article that "adjudicated offenders represent the closest possible approximation to those who have in fact violated the law, carefully selected by sieving of the due process of law." Tappan felt that Sutherland's position exemplified an anti-business bias.

In response, Sutherland forcefully and eloquently defended his opinion by arguing that what mattered was what an individual actually did in terms of violating the law, not the way in which the criminal justice system dealt with him. In fact, Sutherland was concerned with the fact that existing statutes did not proscribe penalties for white-collar offenses. Sutherland was also deeply troubled with what he termed "differential implementation of law," the process by which higher status offenders were treated more leniently than their poor, lower-class counterparts. Sutherland felt it was important that all criminologists, not just those interested in white-collar crime, should continue to research why the legal system tends to be biased in favor of the wealthy. Most criminologists at the time, and certainly those today, would side with

Sutherland's position. The main flaw of Tappan's viewpoint is that he was suggesting that criminologists should not study what is referred to as the "dark figure" of crime—those offenses which may not be reported to or detected by the police. Tappan's strict legal interpretation of what types of behavior constitute crime was viewed as too narrow, given that much of what criminologists do view as crime occurs much earlier than the conviction stage of the criminal justice system. Unlike in Sutherland's time, today's modern criminologists now have access to data and other sources of information that provide even more evidence against Tappan's restricted opinion.

The "dark figure" of crime is still very much a topic of study, and attempts to measure this elusive form often take the mode of the self-report survey. Additionally, this data source, and also self-report surveys of crime victims, are now viewed as superior to conviction data for several reasons. Studies have demonstrated that biases in sentencing are common, particularly for certain groups of people and also in specific geographic regions of the United States. At an earlier stage in the criminal justice system, the arrest-procedure research has revealed the occurrence of similar biases. For example, studies of police practices have shown that certain groups, such as minority males in low-income neighborhoods, may be targeted more forcefully by the police. Taken together, the existing literature suggests that the study of only one point in the criminal justice system, whether it is arrest, conviction, or an alternative, can lead to unreliable conclusions about social processes.

Although our research and data collection methods have improved considerably since the time of Sutherland and Tappan, criminologists' concern with differential implementation of law remains a critical issue. The answer to the question of why certain offenders receive favorable treatment remains elusive at best.

#### SEE ALSO

Sutherland, Edwin H.; prosecution; differential association; self-control theory.

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## sweepstakes fraud

EACH DAY SWEEPSTAKES entries arrive in the homes of millions of people around the world through the telephone, in the mailbox, or in e-mail. Companies promoting sweepstakes offer everything from diamond rings to millions of dollars; and according to the Department of Justice, one out of every six Americans is cheated by sweepstakes scam artists each year. A survey conducted by the National Consumers League (NCL) found that 92 percent of adults had received at least one postcard in the mail telling them they were sweepstakes winners. Approximately one-third of the recipients answered the postcards, but less than 20 percent of the 54 million respondents in the NCL survey won a prize without paying a fee or buying a product.

### TARGETING SENIORS

Many sweepstakes are legitimate, but an increasing number are simply scams designed to entice gullible people into sending money, buying unwanted and often inferior merchandise, or giving away personal information that allows scam operators to steal identities.

The Federal Bureau of Investigation (FBI) reports that in almost 80 percent of the sweepstakes fraud cases investigated, victims are elderly. Publishing Clearing House (PCH), the best known of the large sweepstakes companies, estimates that at least 30 percent of its entrants are over 65 years old.

The elderly may be more vulnerable to sweepstake scams because they may be lonely, suffering from cognitive impairment, or simply more trusting. Marketing to the elderly may be as subtle as adding a familiar touch to the sweepstakes offer by addressing the recipient by name, or it may be as blatant as advertising in cemeteries. In August 2003, Alder Woods Group, Inc., installed 8-foot by 10-foot signs at the entrances of its 200 cemeteries,

inviting visitors to enter a sweepstakes in which they might win from \$2,000 to \$25,000.

An elderly person may send money to fraudulent sweepstakes companies for months or years before authorities are notified. An elderly woman in Colorado, for example, wrote more than 2,000 checks totaling \$107,000 over a 14-month period before it was reported. A Colorado man in his 70s became so obsessed with entering sweepstakes that he rented a post office box to receive the entries and locked himself in his room each day where he wrote checks from \$5 to \$50 totaling hundreds of thousands of dollars before his family discovered his secret and reported it.

After being asked to send a map to her home, one 78-year old Florida woman had friends waiting to watch her receive her prize from representatives of Publishers Clearing House. The company, who had no association with PCH, never came. Another elderly woman spent one-half of her social security check each month buying products from companies because she thought that purchasing improved her chances of winning. In an effort to educate the elderly about sweepstake scams, in 1999 Congress passed the Protecting Seniors from Fraud Act (Public Law 106-534), requiring the assistant secretary of Health and Human Services for Aging to work with state attorneys general to educate seniors about sweepstakes fraud.

One of the most common sweepstakes scams involves notifying an individual that she has won millions of dollars that will be transmitted only after the recipient sends a cashier's check, money order, or Western Union transfer to prepay taxes, cover shipping and handling, or make a nonrefundable deposit. Gloria Vettor, a Canadian bookkeeper in her 50s, was so anxious to win the \$850,000 that she was told she had won in a sweepstakes that she embezzled the \$82,140 "cover fee" from her employer. After responding to the first offer, Vettor was put on a "sucker list" and was contacted by scores of other fraudulent sweepstake companies to which she also sent money. After embezzling \$8,768,000 from her employer over ten months, Vettor was arrested and sent to jail. Out of the \$2.7 million that Vettor was told she had won, she never received a penny.

States have also passed laws against sweepstakes fraud and have successfully sued a number of sweepstakes companies. West Virginia, which has reported more victims of sweepstakes than any

other state, sued 106 companies for sweepstakes fraud in 1994. During that same year, 14 states filed suit against PCH, forcing the company to reform the way it conducts sweepstakes. PCH paid \$490,000 to be distributed among thousands of sweepstakes entrants who were misled by wording in their sweepstakes information. Massachusetts won a \$250,000 settlement from Direct American Marketers after the company led a number of entrants into thinking each had won \$7,500. Over 15,000 respondents paid approximately \$15.92 per call to 900 numbers to confirm nonexistent winnings.

Asking sweepstake respondents to call 900 numbers is a common tactic of sweepstake scam artists. Companies ask "winners" to call a 900 telephone number to verify personal information. When the entrant calls the 900 number, the sweepstakes company receives a percentage of the call, netting millions of dollars a day. Investigative journalists have reported that, in some cases, 900 operators are instructed to keep respondents on the phone as long as possible in order to raise costs.

The number of sweepstakes scams has become so extensive that it has taken on international proportions. In July 2001, the Better Business Bureaus in both the United States and Canada warned of a sweepstakes scam asking residents of the two countries to send large amounts of money to an address in Canada. In October 2003, Spain discovered a sweepstakes scam involving American and Canadian victims who were told they had won El Gordo, a legitimate Spanish Christmas sweepstakes. To collect their winnings, some victims traveled to Spain and were bilked out of thousands of dollars.

On December 13, 1999, President Bill Clinton signed the Deceptive Mail Prevention and Enforcement Act (Public Law 106-168), making it illegal to falsely announce that a person has won a sweepstakes or to make it appear that sweepstakes promotions are official government documents. The law also provided civil penalties for sweepstakes promoters who do not include the following information in sweepstake rules and on entry forms: A statement saying that no purchase is necessary to enter and that purchasing products from the company does not improve chances of winning; terms and conditions of the sweepstakes; odds on winning; the quantity, estimated retail value, and nature of each prize; and a schedule of payments for prize winners. Under the law, companies are required to

remove the name of anyone from their lists requesting them to do so, and all sweepstakes information must contain the name and complete address of the promoter as well as a toll-free number to facilitate requested removals. The United States Postal Service was given the authority to prosecute offenses and to levy fines as high as \$2.0 million for sweepstakes fraud.

The Federal Trade Commission has established the 900 Number Rule, mandating the inclusion of an introductory message that notifies the entrant of the odds of winning the sweepstakes or how sweepstakes odds are calculated. Advertisements for 900 numbers are required to include: the total cost of calls whenever a flat fee is charged, a per-minute charge where applicable, the range of fees where different rates are applicable, and costs for any transferred 900 number calls. The print size of this information must be at least half the size of the 900 number in the advertisement.

#### SEE ALSO

mail fraud; telemarketing fraud; internet fraud; scams; Better Business Bureaus.

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## Switzerland

A NUMBER OF BOOKS and movies have depicted Swiss banks as the ideal place to hide money

from inquisitive Internal Revenue Service agents, criminal prosecutors, or rightful owners of stolen funds. In common with other tax havens, Switzerland levies minimal taxes and encourages large investments by foreign interests. Switzerland has the additional advantage of strict laws on banking security. Swiss law establishes criminal penalties for those who irresponsibly, either through direct action or negligence, violate banking secrecy.

While it is possible to place money in bank accounts in Switzerland that are known to most bank employees only through numbers or passwords, bank officials have always known the names of account holders. In order to provide some protection for themselves, Swiss banks are restricted to opening numbered accounts only for those foreigners who are already customers of Swiss banks or who have passed a rigorous screening process of interviews and reference checks. Because of its banking laws, Switzerland has become one of the leading financial powers in the world.

On January 1, 1983, International Mutual Assistance in Criminal Matters (IMAC) took effect in Switzerland. The law extended the rights of foreign investigators and gave foreign prosecutors the same powers as Swiss prosecutors within Switzerland. IMAC also made it easier for foreign countries to pursue income-tax evaders. Switzerland has historically been the recipient of funds garnered through a number of means used to avoid paying taxes: under-invoicing, which allows firms to hide profits from sales by underreporting them; compensation, which depends on the practice of using third parties in over-invoicing schemes; transferring negotiable assets directly to Swiss banks; and fraudulent accounting, which allows firms to claim losses while depositing hidden profits in Swiss banks. Switzerland has cooperated with other nations in preventing Swiss banks from being used in illegal activities.

Beginning in 1998, Swiss law has considered it a criminal offense for Swiss bankers to refuse to name the sources of wealth behind numbered accounts and has forced bankers to identify any "end beneficiaries" connected to accounts opened by other parties. In addition to Swiss bankers, Switzerland also forces attorneys, stockbrokers, and employees of other financial institutions to comply with the requirement to report suspicions of money laundering. Changes in Swiss banking laws in 1998 arose partly from a banking scandal concerning the Nigerian dictator Sani Abacha in which

banks all over the world had been involved in the deposit of approximately \$3 billion of Nigerian funds. Both the Abacha family and Nigeria claimed the funds. Nineteen Swiss banks had accepted more than \$660 million from Abacha. Even though the banks had suspected money laundering, they did accept the money. The Swiss Federal Banking Commission particularly criticized *Crédit Suisse*, *Crédit Agricole Indosuez*, *Union Bancaire Privée*, and *MM Warburg* for failing to run sufficient checks on the Abacha accounts. In 2001, the commission ruled that Swiss banks could not justify their actions by claiming that the money had come from reputable intermediaries, or by insisting that the Abacha family had provided "glowing references."

## NAZI TIES

Switzerland's history of banking secrecy arose legitimately from Nazi leader Adolf Hitler's attempt to commandeer the assets of Jews who escaped Germany or who were annihilated during the Holocaust during World War II. Unfortunately, Swiss banking secrecy and the chaos of the Holocaust allowed Swiss banks to hold the money for over 50 years. On August 13, 1998, Switzerland announced a payment of \$1.25 billion to be distributed among approximately 100,000 Jews who either survived the Holocaust or who were descendants of those who died. Many people believe that Swiss banks are still holding large amounts of money that should rightfully be theirs. While the original intent of Swiss banking secrecy was laudable, Swiss banks have often become the repository for goods received through fraudulent endeavors such as arms smuggling, narcotics trafficking, computer fraud and theft, consumer fraud, circumvention of export controls, corporate takeovers, and bank frauds.

U.S. tax laws require American citizens who have deposits of over \$10,000 in foreign banks to report those deposits to the Internal Revenue Service. Specific agreements with the United States requires Swiss banks to render "unlimited" assistance to representatives of the American government who are pursuing violators of crimes that are also punishable under Swiss law. The issue with using Swiss banks as tax havens is that, in Switzerland, income-tax invasion is a misdemeanor. Changes in Swiss law in 1982 did, however, prohibit all banks from maintaining accounts for individuals and companies that the banks suspect of knowingly using

their Swiss accounts to assist in tax evasion. Critics of the attempt to stop Americans from using tax havens argue that the United States should not tax citizens who live outside the United States. This rationale is used to defend the practice of depending on tax havens to shield wealthy Americans from exorbitantly high taxes. In truth, some people will always think that tax rates are too high and will spend a good deal of time finding ways to circumvent paying the government.

SEE ALSO

bank fraud; tax evasion; offshore entities.

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# T

## Tailhook Scandal

THE TAILHOOK Association is a private organization whose membership includes active duty, reserve, and retired U.S. Marine Corps and Navy flyers, defense contractors, and others. The Tailhook symposium, a reunion of flyers, began in 1956. It moved from San Diego, California, to Las Vegas, Nevada, in 1963, becoming more than a reunion by adding seminars and professional development activities. From the initial symposium, the U.S. Navy and defense contractors provided significant support to the annual meeting, and the board of directors and president were customarily active and retired naval flyers. As of 1992, the membership consisted of 10 corporations and over 15,000 individuals.

The activities of the association came under close examination in 1993 when Navy Lieutenant Paula Coughlin publicly disclosed on ABC News what had transpired at the Tailhook convention she attended. Coughlin was a helicopter pilot and admiral's aid. Even if she knew that there was wild partying at the Tailhook conventions, she thought she was "one of the guys." That is, until she stepped off the hotel elevator into the gauntlet of officers who grabbed at her body and clothing and made raucous comments. As it happened she was one of many, male and female, who suffered the same indignities.

It didn't help that Admiral John W. Snyder acknowledged her objection by saying, "That's what you get when you go on the third deck full of drunk aviators."

Coughlin filed charges, got tired of the delays in official channels, and went public. After seven months, the Naval Investigative Service and the inspector general reported that they had investigated 140 cases of misconduct. Tailhook was a debauch, with 80 to 90 victims. H. Lawrence Garrett III, secretary of the navy, ordered the navy and marines to begin disciplinary action against 70, including 50 charged with forcing women to run the gauntlet and six accused of obstructing the investigation. The secretary and Chief of Naval Operations Frank Kelso were at Tailhook but failed to intercede. Both denied being aware of the harassment, but when witnesses placed them near the gauntlet, Garrett resigned immediately and Kelso retired early when the Senate, by a 54 to 43 vote, allowed him to retire with his four admiral stars intact.

Kelso and Garrett had previously tried to improve women's status, to open opportunity, to discourage sexual harassment. And in 1992, Kelso had sought Senatorial permission for women to fly in combat. Tailhook undid all of that.

Immediate damage was extensive. Coughlin's boss, Snyder, was relieved of duty for ignoring her complaints. Three admirals were censured, a career-

ending black mark, for not stopping the behavior. Thirty more admirals got letters of caution put into their permanent records. And more than three dozen captains and commanders and marine colonels received fines or letters of censure or reprimand. In total, 117 officers were implicated in one improper behavior or another; only 10 junior grade officers received letters of admonition or fines. There were innocent bystanders, too. One commander was unfairly denied promotion in 1995 because he was in Las Vegas at the time; he was not however at Tailhook, and a court of inquiry exonerated him.

### MANHANDLING

Coughlin described her manhandling and harassment by drunken male officers, and the ramifications widened quickly. The story spread, forcing some senior officers into retirement and effectively ending the careers of others. It also generated a controversial investigation. During her testimony, Coughlin came under attack because of discrepancies in her testimony and a lack of corroborating witnesses. Interviewees could not remember or chose not to testify. The investigation ended inconclusively.

Coughlin and six other victims sued the Hilton hotel and the association. The Tailhook Association settled out of court, and Coughlin won \$1.7 million in compensatory damages and \$5 million in punitive damages, later cut by the judge who removed the Tailhook settlement and reduced the punitive damages to \$3.9 million, three times the compensatory. The next chief of naval operations, Michael Boorda, attempted to assist Coughlin by moving her into his office, Naval Personnel. Coughlin resigned in 1995, and the Hilton hotel appealed.

Optimists believed that Coughlin's exposure of Tailhook made the navy unable to pretend that sexual harassment and sexual crimes were not a problem. This case was the beginning of the stepping forward of military women and the exposure of sex discrimination and other abuses that had been occurring since the end of the draft in 1973, and the active recruitment of women.

The increase of women from only 1 percent of the force, and the demands of women for equal opportunity made virtually all jobs unisex (excluding only direct combat, and that was tenuous). The military was stressed by the changes, and the logical

culmination was Tailhook. The other services also became more aggressive in tracking such claims.

Meanwhile, at the Air Force Academy, a pattern of comparable behavior persisted, and the services periodically had flare-ups of sexually inappropriate behavior. Tailhook remained controversial a decade later, with defenders of the services and the "old boy culture" finding fault with Coughlin, accusing her of behavior detrimental to the navy and marines, and of distortion of the events for her own advantage. The tensions released by the inclusion of women in virtually every aspect of the military in significant numbers remained unalleviated despite 10 years of promised increased vigilance and education and reform.

### SEE ALSO

sexual harassment; gender discrimination.

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## tampons and toxic shock

DOCTOR JAMES K. TODD of the University of Colorado first identified Toxic Shock Syndrome (TSS) in 1978. TSS is a type of blood poisoning caused by the release of toxins from the growth of bacteria. TSS develops from a common bacterium, *staphylococcus aureus*, which can live on the skin and in the nose, armpit, groin, or vagina.

Though the disease is rare, it can be fatal. Symptoms of TSS include high sudden fever, muscle aches, vomiting, diarrhea, rashes, rapid pulse, fatigue, sore throat, dizziness, fainting, and a drop in blood pressure. Although TSS can arise from

wounds or infections and is seen in some men, it normally manifests in women 30 years old and younger. The most common cause of TSS is tied to the use of super absorbent tampons which trap the bacteria and act as a breeding ground when left in place for extended periods.

Super absorbent tampons were being marketed by numerous companies in the mid-1970s, including Procter & Gamble, Playtex, Tampax, Kimberly Clark, and Johnson & Johnson. Initial concerns about the tampons were based on anecdotal evidence and appeared in the absence of scientific research. Court documents suggest, however, that manufacturers were aware of the link between the tampons and TSS but continued to market the dangerous product.

Matters worsened for the manufacturers when the Centers for Disease Control (CDC) entered the fray in 1980. The CDC's investigation focused primarily on the Rely brand tampon. Ultimately, the CDC identified 55 fatal cases and 1,066 nonfatal cases of TSS, though companies continued to sell the product without warnings of the possible risks. A CDC study showed that 70 percent of the victims of TSS reportedly used Rely tampons. Eventually 38 deaths were attributed to the tampon.

Procter & Gamble's ultra-absorbent tampon, Rely, was introduced in 1974. The company released the new, improved product with claims of having conducted extensive research on its safety. Rely was the only tampon that used a highly absorbent synthetic material, polyester foam. The corporation introduced the Rely tampon in a fiercely competitive market but had hopes of out-selling Tampax, the leading product. Procter & Gamble later claimed that the sales of Rely amounted to less than 1 percent of the company's total consolidated annual revenues of \$10.8 billion.

When the Rely tampon first was released in a test market, the company logged more than 100 complaints per month. In 1980, Procter & Gamble sent 60 million sample packages directly to households across the nation.

Rely was voluntarily recalled by the company on September 22, 1980 based on the CDC's studies, finished in June 1980, that linked incidents of TSS with the use of tampons. The cost of the recall to the company was estimated at \$75 million and was done only under protest. The company continued to claim that the Rely tampon was not defective and that TSS would continue to occur even after the

tampon was removed from the market. The company's agreement with the Food and Drug Administration (FDA) also included a massive advertising campaign that began in October with ads on 600 television stations, 350 radio stations, and 1,200 newspapers designed to reach all American households. The agreement included a detailed plan to provide consumer refunds, and prohibited the sale of the tampons overseas or in the United States without prior FDA approval. Nonetheless, Procter & Gamble faced some 400 civil lawsuits.

## ON TRIAL

In the first public trial against Procter & Gamble, a federal jury found the company guilty of negligence for failing to conduct adequate testing and for marketing a dangerous product. Deletha Dawn Lampshire, an 18-year-old student at University of Denver, sought \$25 million in damages after using Rely in May 1980. Procter & Gamble argued that the plaintiff had the flu (many TSS symptoms are similar to the flu) and denied any definitive link between Rely and TSS. The company also claimed to have acted in a responsible manner by removing the product from the market after solid, scientific evidence of the danger emerged.

The jury found the company negligent but awarded no compensatory or punitive damages to the plaintiff. Both sides in the Lampshire case filed an appeal following the judgment and eventually settled out of court for an undisclosed amount to avoid a second trial. The second major lawsuit against Procter & Gamble was filed by Michael Kehm who sought \$30 million in damages after his wife died. Patricia Kehm was a 25-year-old housewife and mother in Cedar Rapids, Iowa, who first used Rely tampons on September 2, 1980. She died four days later. In response to the lawsuit, the company used its multi-million dollar litigation fund to hire a slew of attorneys and scientific experts to defend the Rely tampon. Kehm was awarded a mere \$300,000.

Liability for super absorbent tampons haunted other companies as well. A jury in South Carolina found Playtex guilty of recklessness for failing to warn women of the risks. Twenty-four-year-old Linda J. Wooten sued the company after she developed TSS. The jury found that the company had failed to warn women, although Playtex had launched its own advertising campaign that advised

consumers of the TSS risks and inserted flyers in its tampon boxes. The plaintiff was awarded \$3,870 in compensatory damages and \$15,500 in punitive damages; though the award was relatively small it was the first that involved punitive compensation against Playtex.

In February 1985, Betty O'Gilvie's family was awarded \$10 million in punitive damages. The jurors were said to have expressed their "outrage" over the company's actions by imposing a high award after finding that Playtex caused or contributed to O'Gilvie's death from TSS. The 10th Circuit U.S. Court of Appeals determined that Playtex's warning simply mentioning an association between TSS and tampon use was inadequate. The court also found that Playtex deliberately disregarded studies and medical reports linking super absorbent tampons and increased risk of TSS while other manufacturers were redesigning or withdrawing the tampons.

Playtex, in fact, deliberately sought to profit from the situation, according to the court, and therefore, was "grossly negligent or recklessly indifferent to the rights of others." An internal memorandum showed that Playtex knew the tampon was more absorbent than what was necessary: "Our tampons are similar to automobiles which can achieve a speed of 300 miles an hour, but with which 90 percent of the drivers will never exceed 55 miles per hour and the remainder will occasionally drive at speeds up to 90 miles per hour." The memo also noted that by "being obsessed with 'absorbency' we lost sight of the fact that 'leakage' complaints did not decrease as the tampon absorbency potentials were increased. Like the definition of a fanatic, one who redoubles his efforts because he has lost sight of his goals, we then converted our heavier weight tampons to PA fiber, providing even more 'absorbency' and in fact threw in a 3.8 g PA 'Super Plus' for good measure."

Lynette West filed suit against Johnson & Johnson after she contracted TSS using the ob brand tampon. Her case alleged that the tampons were defectively designed, that the instructions were inadequate, and that the company was negligent in testing the product. A jury awarded West \$500,000 in compensatory damages and \$10 million in punitive damages. The trial court granted a motion for a new trial on the basis of excessive damages unless West accepted a reduction to \$100,000 in compensatory damages and \$1 million in punitive damages. Dur-

ing the trial, evidence was presented that, in 1975, Johnson & Johnson began receiving complaints of adverse reactions to ob tampons from consumers and physicians. According to one witness, consumers complained of "irritation, infection, vaginitis, discharge, pain, burning, and rash." Some women complained that the fibers remained in the vagina when the tampon was removed. Others grumbled that the tampons were difficult to remove and in some cases, had to be removed by a doctor. A physician wrote that use of ob tampons had caused severe vaginitis in his daughter, and requested that the company examine its product to "shed some light on the problem."

Consumer complaints attributed bladder infections, vaginal infections, pelvic inflammatory disease to the use of ob tampons. One physician complained that ob tampons swelled too much in the vaginas of young women with intact hymens. Between 1975 and February 1980, the company received approximately 150 complaints, yet Johnson & Johnson made no effort to conduct studies on potential risks. In direct contrast to medical advice, instructions on the ob tampons stated: "Changing tampons too frequently can be uncomfortable," and that users should "try not to change your tampon until it's nearly saturated."

The number of TSS cases has reduced dramatically since the 1980s when super absorbent tampons were removed from the market, though about half the cases reported are still related to tampon use in young women. According to the CDC, in 1997 only five confirmed TSS cases were connected to menstrual-related incidents compared to 814 in 1980. The FDA now requires that all tampon boxes carry a warning that describes the link between TSS and tampon use. The FDA also regulates tampons as medical devices and regulates the absorbency ratings.

#### SEE ALSO

consumer deaths; Procter & Gamble; juries and wards; unsafe products.

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## tariff crimes

TARIFF CRIMES REFER broadly to a range of illegal practices associated with the non-payment of one or more of the various taxes that are levied on goods traded across national borders. Specifically, tariffs are taxes usually applied to imports based on a percentage of the value of the product in question. Along with a complex range of other subsidies, duties, and customs (referred to hereafter as trade crimes), they constitute the chief means for national governments to control and benefit from trade.

Crimes against trading laws and regulations may include outright smuggling of goods to evade tariffs and customs, fraudulent reporting of the amount and value of products, and breaches of quota restrictions. Since tariffs are set by national governments in conjunction with other economic regulations, the nature and degree of customs crimes has varied in different jurisdictions and periods according to economic and political changes. It is necessary to emphasize, therefore, that infractions of trading laws cannot be separated from the differing histories of national states themselves.

### U.S. DUTIES AND TARIFFS

In industrializing countries such as the United States so-called protectionist policies, in which high tariffs were purposely applied to foster industry and garner revenue, were extensive. Soon after the American Revolution, individual states such as Pennsylvania and Massachusetts levied duties to protect their infant textile industries. These duties were codified in the first federal Tariff Act of 1789 which also established the U.S. Customs Service. In addition, this pioneering piece of legislation provided for tariffs for hemp, nails, glass, and iron manufactures. In this period, revenue from tariffs was the principal source of government finances for the struggling American government. Even as American industry began to dominate in many sectors on

an international scale from the 1880s to the 1920s, the U.S. government maintained an extensive tariff system although there were ongoing efforts to establish free trade agreements with Canada. Tariffs were regarded as an important step in the process of economic modernization and national identity. In this context, attempts by smugglers and merchants to skirt tariffs were common and widespread.

During the 1920s and 1930s when alcohol was prohibited, the U.S. concluded a number of bilateral treaties to allow the Customs service to board private vessels. This may have had some deterrent effect on cross-border crimes on a number of products. Yet alcohol smuggling itself skyrocketed during Prohibition, especially between Canada and the United States.

The high tariffs enacted by the United States in the context of the Great Depression of the 1930s, such as the Smoot-Hawley Tariff Act, helped export the economic crisis to the rest of the world as well as to provide economic incentives for smuggling and tariff avoidance. With incomes rapidly declining, however, the market for both legal and illegal goods during the Depression contracted.

### GATT AND NAFTA

After the World War II, the General Agreement on Tariffs and Trade (GATT) was established as an international body to monitor merchandise trade and foster reductions in trade restrictions. While there was some progress toward liberalization of trade, especially between developed capitalist countries, many nations continued to use tariffs as a means to develop their own industry and earn much-needed finances for government coffers. More recently, the North American Free Trade Agreement between Canada, Mexico and the United States (NAFTA, 1991) and the European Economic Union (EU, 1961) have restricted opportunities for trade crimes as tariffs have been lowered across the board.

Two high-value commodities, cigarettes and alcohol, have nonetheless continued to worry customs authorities in Canada and the United States. Canada is the largest trading partner of the United States and vice-versa; they share a large border and a long history of intimate trading relations. Excise taxes on cigarettes introduced by Canada as part of a public health campaign against smoking in 1998 led to a massive differential between the price of cigarettes in both countries.

As a result, a huge incentive was created for Canadians to illegally purchase cigarettes manufactured in the United States, or Canadian-made cigarettes that were exported abroad and resold in Canada. The potential profits of such illegal transactions were enormous. One single trip across the border to sell 50 cartons of cigarettes could result in profits of almost \$15,000. By 1993, 100 million cartons of contraband cigarettes had been consumed in Canada, constituting nearly one in three cigarettes smoked by Canadians.

A similar pattern developed with alcohol. The Canadian government estimated that differences in the price of alcohol between the two countries had led to a 2,250 percent increase in smuggling over the three-year period from 1991 to 1993. Up to 15 percent of all alcohol drunk from 1991 to 1996 was illegally imported from the United States without the payment of customs duties. Only with the reduction of the excise tax, the application of an export tax, and a substantial increase in funding for Canadian customs under an Anti-Smuggling Initiative were the problems of the illegal sale of alcohol and cigarettes resolved.

Modern trade crimes in the United States occur in a myriad of ways. Many products imported into the country are subject to a very complicated system of tariffs and duties which make it practically difficult to regulate. In the huge U.S. market for imported steel, for instance, businesses have used falsified documents and other illegal practices to undercut the competitiveness of U.S.-made steel. Importers, for example, altered shipping documents to make it appear that products are different from what they really are. In this way, high import duties on particular steel products were avoided. Customs inspection of steel products, moreover, were hampered by the fact that many different products look substantially the same and can only be distinguished by time-consuming and expensive methods.

#### CUSTOMS FRAUD

In recent years, the food import industry has also been subject to increasing scrutiny for customs evasion. In one of the largest customs fraud cases ever, the directors of a California company were sentenced to jail and forced to pay \$93 million in back taxes after it was discovered that tens of millions of dollars in imported foods were falsely reported to evade duties and taxes.

Other recent examples of trade crime include: 1) illegal trans-shipments in which imports made in one country are sold through another country to the United States to avoid import quotas; 2) the pirating of U.S. products by foreign importers; 3) undervaluation of goods to pay less duty; 4) the illegal discounting of products (dumping); 5) transfer pricing, where companies undervalue imported parts which will be assembled in the United States; and 6) violation of rules of origin regulations which favor countries such as Canada and Mexico under NAFTA. Most of these types of violations have become openly political as domestic manufacturers pressure the government to crack down on what they see as "unfair" competition.

With the accelerating globalization of economies in recent decades, customs fraud has become acutely international and much more complex. A widening gap between rich, developed countries and poor, developing nations has resulted in a shifting political economy of trade crime. The unequal distribution of wealth between countries has led to a situation in which developing nations have become centers of international trade crime solely because illegal practices are regarded as the only viable economic activity available. Governments in countries with weak economies often overlook, or are involved in smuggling, or do not have the resources to combat trade violations. Countries such as Paraguay, China, Russia and other East European countries have been singled out in this regard. On the other hand, many developing nations charge, with some justification, that despite the rhetoric of free trade, many rich nations have put up unfair trade barriers that force many businesses to skirt the rules.

The future of trade crime and measures to combat it will continue to be shaped by large political and economic forces such as globalization, inequality between nations, shifting international trade policies, the growing power of trading blocs such as NAFTA and the EU and new methods of law enforcement.

#### SEE ALSO

corruption; bribery; Foreign Corrupt Practices Act; tax evasion; corporate dumping.

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## tax evasion

TAX EVASION IS defined as "the willful attempt to defeat or circumvent the tax law in order to illegally reduce one's tax liability." The crime of tax evasion, defined within 26 U.S.C. §7201 and amended in 1984 under 18 U.S.C. §3623, carries the severest criminal penalties and requires the greatest burden of proof on behalf of the U.S. government in comparison to any other tax crime.

The exact statutory language of 26 U.S.C. §7201, entitled "Attempt To Defeat or Evade Tax" reads, "Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation) or imprisoned not more than 5 years, or both, together with the costs of prosecution." The Criminal Fines Enforcement Act of 1984, codified at 18

U.S.C. §3623, substantially increased the maximal permissible fines for both misdemeanors and felonies as set forth in §7201. For felony offenses committed after December 31, 1984, the maximum permissible fine is \$250,000 for an individual and \$500,000 for a corporation. Moreover, if any person derives financial gain from the offense or if the offense results in a financial loss to a person other than the defendant, "the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss."

According to the U.S. Supreme Court in *Sansone v. United States* (1965) §7201 contains two distinct criminal offenses, "the willful attempt to evade or defeat the assessment of a tax; and the willful attempt to evade or defeat the payment of a tax." Evasion or defeat of an assessment involves an attempt by the taxpayer to prevent the government from determining her true tax liability while evasion or defeat of payment involves an attempt by a taxpayer to evade payment of that liability.

## ATTEMPTED EVASION

According to the Internal Revenue Service §7201 contains one distinct criminal offense "attempted evasion of any tax," which can be committed by evading the assessment of a tax or by evading the payment of that tax. Nevertheless, §7201 has been described as the "capstone of a system of sanctions that were intended to induce prompt and forthright fulfillment of every duty under the income tax law and to provide a penalty suitable to every degree of delinquency."

Most commonly, a taxpayer may attempt to evade or defeat the payment of a tax liability by filing a fraudulent tax return that omits or understates taxable income and/or claims deductions to which the taxpayer is not entitled. This falls under the category evasion of assessment. Evasion of payment occurs when a taxpayer attempts to evade payment of her tax liability altogether. Evasion of payment occurs only after the existence of a tax liability has been established. Establishment of a tax liability generally occurs in one of three ways: the taxpayer reports the amount of the taxes owed; the Internal Revenue Service (IRS) assesses the amount of taxes owed; or by operation of law on the date the return is due the taxpayer fails to file a tax return and the government can prove a tax deficiency. Merely failing to pay assessed taxes, however, does not consti-

tute evasion of payment. The taxpayer must have taken some affirmative action. Generally, affirmative acts associated with evasion of payment involve concealment of the taxpayer's ability to pay taxes, dealing in currency, or the removal of assets beyond the reach of the IRS such as placing assets in the names of others.

## ELEMENTS OF PROSECUTION

To obtain a conviction for tax evasion under §7201 the government is required to prove three elements: the existence of a tax deficiency; an affirmative act constituting evasion or attempted evasion of the tax; and willfulness. As in any criminal prosecution, the government must prove each element beyond a reasonable doubt. Failure to prove any one of the three elements will most likely result in an acquittal.

The first element that must be proven by the government is the existence of a tax deficiency. Therefore, the government must prove beyond a reasonable doubt that the defendant had greater taxable income than reported. Some courts have required the tax deficiency to be substantial. Tax evasion cases, however, are not tax collection cases so the government need not prove the exact amount owed only that a tax deficiency exists. Furthermore, since taxes are paid annually, each tax year is considered a separate offense.

There are two methods of proof used for establishing the existence of a tax deficiency: the direct or specific item method and the indirect method. The direct or specific item method is considered the simplest and most accurate means of proving a tax deficiency. Under this method, the government's case is based on specific, identifiable transactions such as a defendant's books and records providing direct evidence revealing the fact that the defendant has failed to report all taxable transactions, or testimony from a third party revealing money paid to the defendant for goods or services. Proof of unreported taxable income by means of the direct or specific item method, however, is extremely difficult and often impossible for the government to obtain.

Alternatively, the government may prove the existence of a tax deficiency by using indirect methods such as the net worth method, the cash expenditures method, and the bank deposits method. The most common indirect method used by the government to prove the existence of a tax deficiency is

the net worth method. The method examines the defendant's net worth or net value of all the defendant's assets on the last day of the tax year immediately preceding the first prosecution year. The defendant's nondeductible expenditures and living expenses are added to these increases. If the resulting figure is substantially greater than the taxable income reported by the defendant for that year, the government claims the excess represents unreported taxable income. To be successful using the net worth method, the government must establish the defendant's net worth at the beginning of the year with "reasonable certainty."

Once an increase in the defendant's net worth has been proven with reasonable certainty, the government must introduce evidence supporting the conjecture that the unreported income is taxable. The government can do so by establishing a "likely source" for the unexplained income or by negating all possible nontaxable sources of income. Moreover, if the defendant offers an explanation for the source of the unreported income, the government has a duty to investigate all reasonable explanations offered by the defendant as proscribed by the reasonable leads doctrine.

The reasonable leads doctrine, established by the Supreme Court in *Holland v. United States* (1954), places on the government the duty of "effective negation of reasonable explanations by the taxpayer inconsistent with guilt" and a duty limited to the investigation of "leads reasonably susceptible of being checked, which, if true would establish the defendant's innocence."

To prove a tax deficiency by means of the cash expenditures method, the government must prove that a defendant's expenditures have exceeded the defendant's reported taxable income. This method is typically used in cases where the defendant does not purchase durable assets but rather consumable items such as vacations, lavish dinner parties, and entertainment. In most cases the defendants are gamblers or involved in the distribution of narcotics. As in the net worth method, the government must introduce evidence supporting the conjecture that the unreported income is taxable.

To prove a tax deficiency by means of the bank deposit method, the government totals the amount of all cash expenditures and all deposits made to the defendant's bank account. The government then simply compares this figure to the defendant's reported taxable income. If the total of cash expen-

ditures and deposits is substantially greater than the defendant's reported taxable income, the excess represents the defendant's unreported taxable income. As in the other indirect methods of proof, the government must introduce evidence supporting the conjecture that the unreported income is taxable.

The second element the government must prove for a conviction under § 7201 is "an affirmative act constituting evasion or attempted evasion of a tax." In other words, the government must prove that the defendant purposely and willfully attempted to evade or defeat a tax payment. The Supreme Court, in *Spies v. United States* (1943), set forth illustrations of conduct, termed "badges of fraud," from which willful attempt could be inferred.

The examples provided by the court were: "keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books and records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely of which would be to mislead or conceal."

The final element the government must prove for a conviction under § 7201 is willfulness. The element of willfulness can be the most difficult element to prove since an admission or confession is very seldom available. Therefore, the government generally relies on the defendant's conduct, past record of compliance, knowledge, and education. Examples of willfulness include: failure to provide an accountant with complete and accurate information; making false statements to agents of the IRS; keeping a double set of books; and extensive use of currency or cashiers checks.

The Supreme Court struggled for 43 years to define willfulness. It first attempted to define willfulness in *United States v. Murdock* (1933). According to the court, willfulness "denoted an act which is intentional, or knowing, or voluntary, as distinguished from accidental." Ten years later in *Spies v. United States* (1943), it interpreted willfulness to mean, "An act committed with bad purpose; without justifiable excuse, stubbornly, obstinately... or with bad faith or evil intent." Finally, the Supreme Court ended the confusion in *United States v. Pomponio* (1976), stating that the earlier courts "assumed that the reference to an evil motive meant something more than the specific intent to violate the law." The court then set forth a standard defini-



*The U.S. Supreme Court spent four decades trying to define willfulness in tax evasion charges.*

tion of the term simply defining willfulness as a "voluntary, intentional violation of a known legal duty."

## DEFENSES

After the government has proved beyond a reasonable doubt the three elements necessary to obtain a conviction for tax evasion under § 7201, a defendant may assert a number of defenses refuting any one of the three elements proven by the government. The defenses typically used to refute the government's case include: proving the lack of a tax deficiency; proving the lack of willfulness; third party liability or reliance; selective prosecution; and cash on hand or cash hoard defense.

A conviction may be avoided under § 7201 if a defendant can successfully refute the government's claim that a tax deficiency exists by proving that the additional income received was in fact nontaxable in nature. Nontaxable sources include gifts, loans, and inheritances. Moreover, in cases involving the indirect method of proof, a defendant may refute the tax deficiency by identifying errors in the government's analysis or claim that the government failed to fully investigate any explanation offered by the defendant.

A conviction may also be avoided under § 7201 if a defendant can prove that the tax deficiency was evaded in a non-willful manner. According to the Supreme Court in *Cheeks v. United States* (1991), a good faith belief that one is not violating the tax law negates the element of willfulness. Furthermore, willfulness can be refuted when there is uncertainty in the tax law. In 1921, the Supreme Court held that a criminal law that fails to establish an ascertainable standard of guilt is unconstitutional on two grounds. First, the statute violates the Due Process Clause of the 5th Amendment. Second, it violates the guarantee of being informed of the nature and causes of the criminal charges brought against the defendant as proscribed by the 6th Amendment.

A conviction may also be avoided under § 7201 if a defendant shifts the responsibility of a tax deficiency to a third party such as an attorney or accountant. Reliance on the advice of a third party does establish a complete defense and does negate the element of willfulness, which is a "substantial part of the charge." To be successful using the defense of third party reliance, a defendant must show that he consulted with a competent attorney, made a full and accurate report of all material facts of which he had knowledge, and then acted strictly in accordance with the advice provided to him by the attorney or accountant.

A defendant may claim the defense of selective prosecution to avoid a conviction under § 7201. When a defendant claims selective prosecution, she claims that the government's decision to prosecute is based on reasons forbidden by the U.S. Constitution, and in particular the Due Process Clause of the 5th Amendment. The Due Process Clause forbids prosecutions based on "race, religion, or other arbitrary classification."

To be successful, the defendant must clearly present sufficient evidence showing that federal prosecutorial policy has both a discriminatory ef-

fect and discriminatory purpose. The mere belief or suspicion on behalf of the defendant is insufficient.

Lastly, the defendant may avoid a conviction under § 7201 by claiming the cash on hand defense, commonly referred to as the cash hoard defense. Cash on hand refers to the money that a defendant carries in his pockets as well as money or cash available to the defendant, which is not deposited in a bank or other financial institution. Typically, a cash hoard defense is based on a claim that the defendant received gifts from family members, friends, or an inheritance, received in an earlier year and spent during the prosecution period. The Supreme Court has defined the cash hoard defense as a "taxpayer's claim that the net worth increase shown by the government's statement is in reality not an increase at all because of the existence of substantial cash on hand at the starting point... asserting that the cache is made up of many years' savings, which for various reasons were hidden and not expended until the prosecution period." The government has great difficulty in refuting the cash hoard defense. One way the government does refute the cash hoard defense is by proving to the court that the family member or friend implicated lacks the resources to give the defendant the amount claimed.

## HIGH-PROFILE TAX EVASION

Federal taxes are the principal source of revenue for the U.S. government. The federal tax system is based upon the idea of "voluntary compliance." Each person is "expected to account annually for his or her income and deductions and to pay the proper amount of tax." Therefore, in order to foster voluntary compliance, the government must impose taxes that are construed by the American taxpayers as fair and must penalize those who fail to comply. The IRS, a branch of the Department of the Treasury, is responsible for investigating and penalizing those who fail to comply with the system of voluntary compliance.

The Criminal Investigation Unit (CIU) of the IRS is responsible for investigating any potentially criminal violation of the Internal Revenue Code, such as the widespread allegations of tax fraud, including tax evasion, in such a manner that "fosters confidence in the tax system and compliance with the law." Since its inception in 1919, the CIU's conviction rate for federal tax prosecutions has never fallen below 90 percent, a record unmatched in fed-

eral law enforcement. The CIU is famous for the financial investigative skills of its special agents; it gained national prominence in 1930 for the conviction of Al Capone, public enemy number one, for income tax evasion. According to the IRS, one of the most effective deterrents in enhancing voluntary compliance in the tax law is by publicly making examples of well-known individuals who fail to comply with the tax law, as was case with Capone.

Between 1988 and 2002, the IRS successfully prosecuted three well-known individuals in the United States for their failure to comply with the tax laws as stipulated within 26 U.S.C. §7201. In April 1988, a federal grand jury indicted Leona Helmsley, a hotel chain executive along with her husband Harold, on 47 counts of attempted tax evasion, conspiracy, filing false tax returns, and mail fraud. The indictment alleged that Helmsley's used various Helmsley-controlled companies to pay for \$2.6 million in extravagant restoration improvements to Dunnellen Hall, the couple's 28-room estate in Greenwich, Connecticut.

Her defense suffered immeasurably when a witness testified that Helmsley had boasted, "We don't pay taxes. Only the little people pay taxes."

In a second highly publicized trial, country singer Willie Nelson was found guilty of tax evasion in 1993 and fined \$32 million after a criminal investigation revealed that Nelson owed \$11 million in back taxes from 1972 to 1983. Moreover, the IRS alleged that Nelson had attempted to hide earnings in a fraudulent tax shelter. The IRS seized Nelson's assets including his 44-acre ranch in order to recoup the \$16.7 million Nelson owed in interest and penalties as result of the tax evasion charges. Nelson, who lacked the sufficient resources to satisfy his debt with the Internal Revenue Service, was able to settle the case out of court by agreeing to pay an additional \$9 million over a five-year period.

In January 1997, "Hollywood madam" Heidi Fleiss was sentenced to 37 months in prison, fined \$400, and ordered to complete 300 hours of community service after being found guilty of tax evasion, pandering, and money laundering. Fleiss, who ran one of the most successful escort services in the United States, reportedly earned millions of dollars and failed to report her income, obtained by improper means, to the IRS. According to District Court Judge Consuelo Marshall described the Fleiss case as "atypical and even the minimum sentence would have been far too harsh," relying on an

expert witness who testified that the federal sentencing guidelines for money laundering were drafted with organized criminal enterprises and drug cartels in mind, not madams.

The IRS initiated 3,906 criminal investigations under §7201 for the fiscal year ending 2002. Of the criminal investigations initiated 2,133 were referred for prosecution, 1,926 were convicted, and 1,809 were incarcerated. Voluntary compliance with the tax laws of the United States has declined and according to the IRS, investigating and prosecuting tax crimes is "key in promoting voluntary compliance with the tax laws."

#### SEE ALSO

offshore banking; offshore entities; United States; Capone, Alphonse; accounting fraud.

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## Teamsters Pension Fund

THE TEAMSTERS Pension Fund, formally the Central States, Southeast and Southwest Areas Pension Fund, was created in the mid-1950s and came to be known by many as organized crime's bank.

The corrupt use of the fund has been well documented beginning in the 1960s in numerous investigations, commissions, reports, prosecutions and media forums.

The fund gained notoriety because International Brotherhood of Teamsters (IBT) Pension Fund managers would loan money from the fund to organized criminals, usually through straw men, for casinos, hotels, and resorts. The recipients of the fund proceeds included such noteworthy establishments as Las Vegas, Nevada, casinos Circus Circus, Caesar's Palace, the Dunes, and the Sands. So-called finders fees were charged, kickbacks were common, and loans were years delinquent but carried as assets. All the while, organized criminals battled for cuts of the finders fees and other illicit facets of the massive conspiracy.

#### JIMMY HOFFA

The Central States, Southeast and Southwest Areas Pension Fund was formally set up on March 16, 1955, designed to hold millions (and later billions) of dollars in trust for pensions, life insurance, and disability of Teamsters union members. By 1961, it had assets of approximately \$200 million. Infamous IBT leader Jimmy Hoffa used the fund to assist friends in various deals and, more importantly, to court organized criminals who were pleased (and indebted) to have this resource available for their investments. As one observer, Ronald Goldfarb, wryly noted, "the pension fund had become the mob's savings and loan."

Hoffa was convicted of diverting \$20 million from the pension fund in a 1964 Chicago case, and sentenced to five years in jail. Teamster corruption did not end with the imprisonment of Hoffa, and underlings took on more prominent roles in the scheme. Furthermore, the fund's value continued to grow. In the mid 1970s, the fund's assets totaled approximately \$2.2 billion, and pension payments were almost \$325 million per year.

Throughout the 1960s and early 1970s, the Department of Labor, the Internal Revenue Service (IRS) and the U.S. Senate's Permanent Subcommittee on Investigations (PSI) investigated the fund. By 1975, the Department of Labor was the lead investigative body, and thus created its Special Investigations Staff for the sole purpose of exposing the pension fund scandal. Technically, the Labor Department was to coordinate with the IRS and then

refer founded cases to the Department of Justice for prosecution. For a variety of reasons, including ambivalence (and possibly corruption) within the Labor Department and the IRS, the investigations stalled as documented in the fall of 1980 by the PSI.

During the 1980 presidential election campaign between Democrat Jimmy Carter and Republican Ronald Reagan, each candidate courted the IBT for its weighty support. The pension fund became a focal point in the IBT's decision on whom to endorse. Following several private meetings with such notorious IBT officials as Frank Fitzsimmons, Roy Williams, and Jackie Presser, the Reagan camp was delighted to know they had won the IBT's support. As described by F.C. Duke Zeller, a Teamsters public relations staff member, the key to their support was Reagan's promise to stall or end the Labor Department's pension fund investigation.

Zeller recalls Presser's impassioned plea to his IBT cohorts to support Reagan: "You Italians, listen up! Especially you Italians! More than anyone else in this room, you should be supporting Reagan! Reagan has agreed to lay off us! The Justice Department will not be on our backs for once!" Following Reagan's victory, the president visited the Teamsters' headquarters and "invited the Teamsters high command to help him select his secretary of labor and other top administration officials," Zeller notes.

Many Reagan critics thought it remarkable that someone being sued by the Labor Department for over \$120 million in illegal loans to Las Vegas casinos and gangsters was helping to organize the very department suing him. The Teamsters recommended Raymond J. Donovan for secretary of labor and he became the Reagan nominee and secretary. In the next year, Donovan was asked by the PSI to investigate IBT President Williams regarding "his conduct as a fiduciary of union trust funds." Donovan declined to look into the pension fund scandal, claiming the Labor Department had no authority in the matter.

The legend of the Teamsters Pension Fund, based in large part on real life events, has been promulgated by print media, fiction, and non-fiction authors, and by Hollywood. The 1995 movie *Casino* prominently featured the fund's role in the development of Las Vegas.

#### SEE ALSO

organized crime; corruption; Reagan, Ronald; fiduciary fraud.



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## Teapot Dome Scandal

WARREN G. HARDING (1865–1923), who is considered by most political scientists and historians to have been one of the worst presidents in the history of the United States, was blamed for the Teapot Dome Scandal, which erupted during the rampant corruption and gaiety of the so-called Roaring Twenties. Although the president was not personally involved in the criminal activities that wrecked his administration, Harding's fierce loyalty to his political cronies and his reluctance to believe in their dishonesty led to his being discredited along with them.

On becoming president, Harding brought what became known as the "Ohio Gang" with him to Washington, D.C. He may have never realized the extent of the corruption practiced by these opportunists who saw the capital as a city ripe for exploitation. While Harding's friends saddled him with a number of scandals, the most serious was Teapot Dome, which came to define the Harding presidency. The scandal involved Harding's cabinet, presidential appointees, the oil industry, and even a few innocent bystanders.

The groundwork for the scandal had been laid during the preceding decades with an increased emphasis on conservation during the presidency of

Theodore Roosevelt and with increased demands for oil during the presidency of William Howard Taft. In 1912, the U.S. Navy began converting its ships from coal to diesel fuel; and in anticipation of the need for increased fuel, Taft decided that government-owned oil reserves or "domes" at Elk Hills and Buena Vista in California should be held in reserve for future naval needs. President Woodrow Wilson further expanded naval oil reserves in 1914 with the addition of a location in Wyoming that came to be known as Teapot Dome because it roughly resembled the shape of a teapot.

### ALBERT FALL

As a well-known lawyer and wheeler-dealer, Albert Fall was a name to be reckoned with in New Mexico; he became one of its first senators when the territory achieved statehood in 1912. In 1921, Fall left the Senate to serve as Harding's secretary of interior. Before accepting the position, Fall had suffered a series of financial setbacks. A number of risky investments had left him with a mortgage he couldn't pay and a ranch in need of serious repairs.

Whether he was innately dishonest, or whether he simply grasped the opportunity to solve his financial problems, Fall decided to use his position for personal profit. His first move was to convince Harding that private oil companies were inadvertently draining the government's oil resources. Harding was already under some obligation to the big oil companies because they had been instrumental in his election. According to Fall, the government's response to the drainage should be to allow the oil companies to lease the reserves instead of obtaining oil at the government's expense.

After only three months in office and with the full support of Edwin M. Denby, the secretary of the navy, Harding issued an executive order placing the oil reserves at Teapot Dome in Wyoming and Elk Hills in California under the Department of Interior, with Fall in charge. Congress agreed to the president's request to lease the naval reserves, and Fall made sure that neither the president nor Congress was aware of the details of the deals.

### LEASING THE OIL RESERVES

In April 1922, without seeking competitive bids, Fall secretly ceded exclusive rights to the Teapot Dome oil reserves to Harry F. Sinclair of the Mam-

moth Oil Company. Sinclair was one of the richest oilmen in the country with worldwide holdings. In exchange for a 20-year lease, Sinclair promised to pay the U.S. government from 12.5 to 50 percent of the proceeds from Teapot Dome's oil reserves, depending on how productive the wells proved to be. Payment was to be made with certificates that the government could exchange for fuel oil, gasoline, and other oil-related products at posts on the Atlantic and Gulf Coasts and in Cuba. The government also had the option of using the certificates to have Mammoth build fuel storage facilities for the navy. After taking charge of the Teapot Dome reserve, Mammoth built a pipeline from the Wyoming reserve to Chicago, Illinois.

A week after finalizing the deal with Sinclair, Fall sought various bids for various construction projects, including the installation of a loading mechanism to be used in dredging a channel at Pearl Harbor, Hawaii. Edward L. Doheny, the millionaire owner of Pan-American Petroleum and Transport Company and a personal friend of Fall's, submitted a successful bid to construct oil storage tanks to be paid for with oil certificates that would ultimately give Pan-Am preference at the Elk Hill reserves. Fall further negotiated with Doheny to build additional tanks for the navy and to fill them with oil. The deal also required Pan-Am to build a refinery in San Pedro, California, and to construct a pipeline between Elk Hills and the San Pedro refinery. As a result of the new relationship between Pan-Am and the government, control of most of the naval reserves at Elk Hill was granted to Doheny. Standard Oil retained control of one section of Elk Hills, and Honolulu Oil was in control at the Buena Vista reserve.

Known only to the principals involved in the transactions, Fall received over \$3 million in Liberty Bonds and other gifts from Sinclair. For his secret deal with Doheny, Fall received \$100,000 in a black bag. Fall later claimed that the payment from Doheny was an interest-free loan. Fall immediately paid his bills, remodeled his ranch, and bought an adjoining piece of property. When questioned about his sudden wealth, Fall insisted that Sinclair had bought a one-third interest in the Three Rivers Ranch. Fall's machinations came to light through a Wyoming oilman who had not been allowed to bid on the naval reserves. Shortly thereafter, a reporter at the *St. Louis Dispatch* newspaper broke the story. Senator Robert M. La Follette of Wisconsin con-

vinced the Senate to appoint a committee to investigate the charges under the leadership of Senator Thomas J. Walsh of Montana. Despite repeated lies, evasions, and a general lack of cooperation from the principals involved in the Teapot Dome scandal, and in the face of repeated attempts by the Harding administration to block the investigation, the Senate dedicated 18 months to uncovering the corruption involved in the scandal. During this period, Walsh's office was ransacked, his telephones were tapped, his mail was opened, his three-year-old daughter was threatened, and his past was investigated. However, Walsh refused to be intimidated by either the Harding administration or the oil magnates.

#### THE AFTERMATH

On August 2, 1923, Warren G. Harding unexpectedly died. Many people believed that he had committed suicide by taking poison, although the official explanation was that he had died from food poisoning. At any rate, Harding never lived to see his secretary of interior and close friend sent to jail. On June 30, 1924, Fall was indicted on charges of conspiracy and bribery. It took another five years before Fall was found guilty of bribery, sentenced to one year in the New Mexico State Penitentiary, and forced to pay a \$100,000 fine. In response to his behavior during the investigation, Congress charged Sinclair with contempt of Congress. During his trial, Sinclair reportedly offered a member of the jury a car "as long as this block" to vote in his favor. Sinclair was then sentenced to three months in jail for contempt and another three months for jury tampering and was fined \$1,000. Ironically, both Sinclair and Doheny were cleared of conspiracy and bribery charges.

At the insistence of Congress, Calvin Coolidge, who had succeeded to the presidency on Harding's death, appointed special prosecutors Republican Owen J. Roberts and Democrat Allen Pomerene to investigate all parties implicated in the Teapot Dome scandal.

#### HARRY DAUGHERTY

Members of Congress had done their best to oust Attorney General Harry Daugherty during their investigations into the Teapot Dome scandal. Many members of Congress had reservations about

Daugherty's character, and they had resented his efforts to protect Fall from the Teapot Dome investigation.

One of the Ohio Gang, Daugherty had been instrumental in convincing Harding to run for president and had been rewarded with the plum job of attorney general. Daugherty had already developed a reputation as a slick promoter, and he was severely criticized for naming con man Jess Smith as his assistant. When Congress and the press reacted to Daugherty's appointment with outrage, the president defended his choice, maintaining that "Henry Daugherty is the best friend I have on earth." After Harding's death, Smith committed suicide, and Daugherty resigned in disgrace in the midst of congressional efforts to impeach him. He was cleared of all charges three years later.

With the investigation of the Teapot Dome scandal completed, Congress nullified the lease on both the Teapot Dome and Elk Hills reserves, declaring them "illegal and fraudulent." In 1927, the Supreme Court upheld the nullification. The U.S. government also received \$6 million from Sinclair and Doheny.

#### SEE ALSO

bribery; corruption; public corruption; conspiracy.

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## techniques of neutralization

GRESHAM SYKES and David Matza (1958) articulated five techniques of neutralization that were derived from observing recently arrested juvenile

delinquents. Neutralizations represent common justifications or excuses for wrongful behavior prior to committing it, in order to alleviate moral guilt. They are: 1) denial of injury (no harm was really done); 2) denial of victim (no crime occurred because the entity against whom the act was committed deserved it); 3) denial of responsibility (it was not the actor's fault); 4) condemnation of condemners (penalizers are hypocrites); and 5) appeals to higher loyalties (the act was done because of an allegiance to a more important principle, like loyalty to a group).

Donald Cressey's classic 1953 work on embezzlers, *Other People's Money*, anticipated by several years the ideas of Sykes and Matza when he found that his subjects had to counteract the criminal nature of the theft before they could steal. Carl Klockars added another neutralization in 1974, the metaphor of the ledger (there are many more good behaviors than bad ones on an individual's behavior balance sheet). Unlike the neutralizations of Sykes and Matza, Klockars's metaphor of the ledger admits that a behavior is wrong. But, it nevertheless shares the fundamental aspect of the other neutralizations—it is an attempt to reduce personal moral guilt. The concept of neutralization makes a plausible contribution to the understanding of many kinds of business crime because most business criminals are generally law-abiding and do not want to think of themselves as immoral.

The term *neutralization* should not be confused with the term *rationalization*, although the two are often used interchangeably. If the excuses described by Sykes and Matza and Klockars are invoked before the offense to repress feelings of guilt, they are neutralizations. If the excuses are used after the offense to repress feelings of guilt, then they are rationalizations. Of the two concepts, only neutralizations can help to explain an offense because they occur prior to the illegal act.

Researchers almost always record these justifications after the crime is committed. This makes it impossible to determine whether a subject used an excuse to neutralize her crime before it was committed, or whether the excuse was created after the crime as a rationalization to avoid self-embarrassment. White-collar criminals have been documented numerous times using denial of injury, especially in defrauding or embezzling from a government or another wealthy entity. In many cases of embezzlement, the thief tries to believe that there is

no harm because the money is merely being “borrowed.” Corporate criminals also use denial of injury when victimizing the public at large. In such cases, the harm inflicted is mild and diffuse when spread over so many individuals (for example, stockholders), so the perception by the criminal is that there is little discernable injury to any single person.

Denial of victim will be used to defend a crime when there is a sense of injustice, such as workers who believe that they are underpaid. Denials of responsibility have been documented in statements such as: “The tax laws are too complex for me to understand,” and “It’s not the organization’s fault that our employees committed crimes.” Condemnation of condemners is used when it is believed that a contemplated victim is in no position to render judgment, such as the water polluter who validates the offense by asserting that government officials are corrupt.

An appeal to higher loyalties often manifests in persons who have strong organizational allegiance—“I did it for the company.” Women who embezzle have also repeatedly invoked this neutralization when they try to substantiate their theft because it provides a better lifestyle for their family or mate. Criminals use the metaphor of the ledger when they view their offense as a rare episode in an otherwise law-abiding history. In essence, the metaphor justifies an illegality based on the many criminal opportunities upon which the offender did not act in the past—the offender perceives a fundamentally good self.

An excuse is a neutralization if it is used once or twice before committing a crime. However, as it becomes utilized on a more regular basis, it turns into a personal belief favorable to the violation of law, and it will eventually become a permanent part of one’s value system. It is easier for people to believe that a criminal behavior is not wrong when they have seen little or no punishment for it.

Neutralizers may be deterred by the threat of punishment associated with their contemplated illegal behavior. Deterred neutralizers appear as though they are moral individuals, but in reality they would be very likely to commit offenses if they did not fear the consequences.

#### SEE ALSO

Cressey, Donald; differential association theory; self-control theory.

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## Teledyne Industries

FOUNDED IN 1960 by Henry Singleton and George Kozmetsky, Teledyne, Inc. was a communications company created to capitalize on the shift from analog to digital technologies. Teledyne has since branched out into several subsidiaries including companies in the fields of electronics, communications, engineering, aerospace, and energy.

Several of these subsidiaries have continued to branch off into separate units of their own. One of the units, Teledyne Industries, is a military contracting company based out of Newbury Park, California, and has been involved in several cases of defrauding the U.S. government, specifically, the Department of Defense. Most of the cases involve inflated pricing and inadequate testing of military equipment.

Between 1980 and 1986, Teledyne Hydra-Power, a unit of Teledyne Industries, defrauded the U.S. Navy of \$4.5 million on a helicopter contract by inflating the price of parts and the number of hours worked. Teledyne paid the U.S. government \$11.9 million to cover overcharges, interest, and penalties. Again, in 1992 Teledyne Industries agreed to pay \$17.5 million to settle a criminal case in which it was accused of 35 counts of submitting false statements between 1987 and 1990. Teledyne sold over 12 million relay switches to the Pentagon without adequately testing them. The relays normally cost \$6 each, but the government paid \$26 per relay so that each one could be tested and certified.

In the course of the 10-year contract, the government would have been defrauded of \$240 mil-

lion. In a similar case, Teledyne paid the U.S. government \$275,000 in 1993 to settle claims that their Firth Sterling division failed to properly test cluster bomb grenades. Ten months later, Teledyne paid the government \$1.5 million and pleaded guilty to three felony counts of submitting false statements about sales to Taiwan in the 1980s. Then, again in 1994, Teledyne Industries paid the U.S. government another \$10 million for failing to perform quality-control tests on parts used in the U.S. Army's Stinger missile. The Environmental Protection Agency also fined Teledyne \$85,000 in 1994 for violating the federal Clean Water Act by releasing excess metals and cyanide in waste water discharged to city sewer plants.

### SETTLING FOR MILLIONS

Perhaps the most noteworthy case against Teledyne Industries is the whistleblower case first filed in 1991 by a former employee. Gerald Dean Woodward, who worked for Teledyne from 1969 to 1990, filed a lawsuit under the federal False Claims Act claiming that Teledyne defrauded the government of millions of dollars between 1986 and 1990. Some of the allegations in the suit included selling military aircraft parts as commercial parts to private individuals and companies, falsifying paperwork to hide these sales, charging the government for parts that they already paid for, and charging the government for time actually spent working on other business. The U.S. government picked up the case in 1996 and Teledyne settled for \$4.75 million. Woodward received \$831,250 from that settlement.

Teledyne is still a major military contractor for the U.S. government. In March 2001, Teledyne was awarded \$17 million for two separate three-year contracts with the U.S. Navy for electron tubes in support of the EA-6B aircraft.

### SEE ALSO

government contract fraud; government procurement fraud; water pollution; False Claims Act.

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## telemarketing fraud

ACCORDING TO the U.S. Department of Justice, telemarketing fraud "refers to any scheme to defraud in which the persons carrying out the scheme use the telephone as their primary means of communicating with prospective victims and trying to persuade them to send money to the scheme." The first widespread fraudulent telemarketing scheme involved the activities of Fifty States Distributors in the mid-1970s in Las Vegas, Nevada. Initially started as a legitimate company, Fifty States sold office supplies to businesses. Barry Schrader, the owner of Fifty States, learned that his office supplies were easier to sell when jewelry or some other item was falsely promised along with the supplies. Eventually, he employed up to 300 people in the scheme to rip off businesses. Fifty States was raided by the federal government in 1979 and closed.

Telemarketing fraud increased significantly in the 1980s. By the end of the decade, the National American Securities Administration Association estimated that Americans "invest[ed] more than \$1 million every hour in fraudulent financial schemes promoted by phone." It is difficult to determine the precise extent of telemarketing fraud, in part because less than 10 percent of victims report their victimization to the authorities. Despite these problems determining the magnitude of this problem, federal officials believe that hundreds of fraudulent telemarketing schemes exist on any given day in the United States. Other estimates from the National Consumers League (NCL) in 2002 suggest that each fraudulent act nets the offender an average of \$845, and the federal government suggests that up to \$40 billion is lost each year to telemarketing fraud.

To fully understand telemarketing fraud, it is important to consider the types of telemarketing fraud, the patterns surrounding these incidents, and

strategies that have been utilized to control these incidents.

## TYPES OF TELEMARKETING FRAUD

The U.S. Department of Justice (DOJ) cites nine different kinds of telemarketing schemes. These schemes vary in their patterns, but are similar in that each aims to take money from victims as quickly as possible. They include the following: charity frauds, investment schemes, credit-related schemes, lottery schemes, magazine-promotion schemes, cross-border schemes, prize-promotion schemes, recovery-room schemes, and internet-related schemes.

Charity fraud occurs when offenders contact individuals and use some bogus charity as a justification to ask for donations. Some charity frauds are referred to as “badge frauds” because offenders will claim that the money will be going to police officers or fire fighters. Also, they may use a number of different strategies to take on the appearance of legitimacy.

For example, some charity fraud schemes may donate a small percent of their profits to a charity, usually less than 10 percent of its profit, to make it seem that they have actually fulfilled their obligations. Others may name themselves with identifiable labels that are easily misconstrued with legitimate charities. One charity scheme, for instance, used the name of the National Lung Association in an attempt to get donors to think they were donating to the American Lung Association.

Investment schemes occur when individuals promise get-rich schemes in exchange for sizeable investments on the part of victims. In the 1980s, common fraudulent investment schemes centered around selling fake coins and strategic metals. In the 1990s, the schemes expanded to include luring investors to dump money into an assortment of businesses including wireless cable and ostrich farms.

Credit-related schemes occur when offenders use the victims’ credit, or lack of credit, as a part of the offense. Three types of credit-related schemes exist. First, credit-card frauds perpetrated as telemarketing schemes entail offenders promising credit cards to those with bad credit in exchange for an exorbitant fee. The credit is usually denied. Second, credit-repair schemes entail promises of credit reparation. It is very difficult, however, to alter credit reports, making these promises completely

unattainable and bogus. Third, loan schemes occur when the offenders offer the victims a loan for a fee. After they pay this fee, victims are eventually referred to a “turn down” room and told that their bad credit prohibited the company from offering the loan.

Lottery schemes are another type of telemarketing fraud. Two varieties of lottery schemes exist. In one variety, offenders call victims promising to invest their money in foreign lotteries for a small fee. Victims have been known to pay thousands of dollars trying to win these lotteries. In another variety, victims are told that they have won a lottery, but they have to pay an administrative fee in order to recover the award. In one case, a 93-year-old man “paid a \$5,000 ‘processing fee’ after being told he’d won a \$1 million lottery prize,” the *Virginian-Pilot* newspaper reported in 1999. The Associated Press ran the story with an accompanying picture showing the man standing outside of Tampa International Airport with a sign around his neck that read, “I’m John. Meeting Sgt. Moore from Canada.”

Magazine promotion schemes are also orchestrated through telemarketing schemes. The most common strategy used in these schemes entails offenders telling victims that they have won a prize that will be supplied if they purchase magazines. The magazines are usually overpriced, and ones that the victim would not select. The problem that arises is that a large number of magazines try to sell their products through telemarketing strategies. The DOJ points out that fraudulent magazine sales can be distinguished from legitimate ones in that they generally do not provide: 1) advance price disclosure, 2) advance magazine title disclosure, or 3) the magazines.

Cross-border schemes originating in other countries are becoming increasingly common. Estimates suggest that one-third of telemarketing complaints are based on calls that originated in Canada. These cross-border scams are more difficult to investigate because of differences in approaches to defining and responding to telemarketing fraud as well as problems getting offenders extradited from their country of origin.

Prize-promotion schemes occur when individuals are told they have won a prize as part of the fraudulent scheme. Three varieties of this scam exist. In the oldest variety, victims are told that they have won something, but they have to pay the taxes on it, upfront. Another variation, the “one in five

scheme,” entails offenders telling victims that they have won “one of five prizes,” but they have to pay an administrative fee. The prize they actually receive is a “gimme prize” that is essentially worthless. The third variety is the “mystery pitch” or “integrity pitch.” Victims are told that they have won something, but the offender is not able to disclose the prize lest they be charged with extortion or bribery, which are entirely baseless claims.

The prize they get is worth far less than what they invested into the contest. According to an article in the *FBI Law Enforcement Bulletin* (1998), “most illegal prize rooms operate on a 10 to 1 principle.” This means that the prizes received by customers are valued at one-tenth of the price they paid. In one scam, consumers were promised a “car telephone.” What they got was a telephone shaped like a car.

Recovery-room schemes target those who have been previously victimized in telemarketing scams. Victims are called by an individual claiming to be a law enforcement official. The caller tells the victim that her money has been recovered from the fraudulent telemarketing ring, but the caller must pay the taxes on the money, or some other fee, in order for the reimbursement to occur. These scams are usually reserved for those victims who have already been bilked out of thousands of dollars. The fact is, however, that law enforcement agencies would never require victims to pay fees for their services.

The DOJ also cites internet-related schemes as a type of telemarketing fraud. Offenders often use telephone lines in these cases, though the communication strategy is usually not oral. The NCL cites the following estimates for the top ten internet frauds occurring in 2002: online auctions (90 percent); general merchandise (5 percent); Nigerian money offers (4 percent); computer equipment or software (.5 percent); internet access services (.4 percent); work-at-home plans (less than .1 percent); information/adult services (less than .1 percent); travel/vacations (less than .1 percent); advance fee loans (less than .1 percent); and prizes/sweepstakes (less than .1 percent).

In 34 percent of the cases, victims paid by credit card, while they sent money orders in about 30 percent of the cases. Checks, bank cards, and debit cards were used in about 27 percent of the cases. With the growth of the internet, these fraud offenses are expected to grow significantly in the coming years.

## PATTERNS OF FRAUD

These schemes are often run like any legitimate business, employing dozens if not hundreds of individuals. They are often located in “boiler rooms,” low-rent motels, or rundown office buildings. Some of telemarketing schemes even have a customer service department which is designed to deal with complaints from the victims. Others may have reload rooms, which include workers whose aim is to convince past victims to fall for the scheme once again.

Participants in the schemes include lead brokers and individuals called “touts” or “singers.” Lead brokers are companies that buy and sell phone numbers of individuals who have been defrauded. The phone numbers they collect are placed on a list euphemistically referred to as a “sucker list.” “Touts” and “singers” are individuals who are employed to provide testimonials for the scheme, but they are actually part of the scheme.

Fraudulent telemarketers will do three things to improve their likelihood of successfully completing the offense. First, they will make it appear as if the goods or services they are providing are worth more than they actually are. Steven Rosoff and other scholars cite an example in which consumers were told they would get a clothes dryer that did not use electricity. They got a clothes line and some clothes pins. Second, fraudulent telemarketers will always ask for quick payment. Third, these businesses will try to do something to make their business look legitimate. Some may assume names that sound official, while others will tell the consumer that the phone conversation is being taped for security reasons.

Note that the schemes vary in how often they are perpetrated. NCL points out that the top 10 telemarketing frauds in 2002 were ranked in the following order: credit card offers (27 percent); work-at-home schemes (18 percent); prizes/sweepstakes (16 percent); advance fee loans (8 percent); magazine sales (5 percent); buyers clubs (4 percent); telephone slamming (2 percent); lotteries (2 percent); travel/vacations (2 percent); and Nigerian money offers (1 percent). NCL adds that victims use their bank debit cards in 37 percent of the cases, their checks in about 16 percent of the cases, their credit cards in 13 percent of the cases, and money orders in 10 percent of the cases. In an additional 13 percent of the cases, victims wired the money to offenders.

## CONTROLLING FRAUD

The three main strategies used to control telemarketing fraud are enforcement, education, and prevention. In terms of enforcement, state and federal authorities have taken an active role in rooting out fraudulent telemarketers. Operation Disconnect was the first nationwide undercover operation designed solely to detect and investigate telemarketing fraud. Undercover Federal Bureau of Investigation (FBI) agents claimed to possess machines that would allow telemarketers to call thousands of people an hour. The agents contacted telemarketers and offered the calling machine. In order for the machine to be designed appropriately for the telemarketer, the undercover agents told the telemarketer that they would have to describe the ways they did business in detail. This essentially resulted in confessions of telemarketing fraud. In the end, over 300 people were arrested and 79 boiler-room operations were closed.

Authorities have also tried to educate the public about telemarketing fraud in order to protect citizens from victimization. The National Consumers League's National Fraud Information Center and the U.S. Postal Service warn consumers to be on the lookout.

Prevention strategies are also used to try to control telemarketing fraud. Consider the National Do Not Call Registry. On October 1, 2003, the federal government implemented the registry, designed to limit the number of telemarketing calls individuals received. Citizens who placed their names on the registry were not supposed to receive calls from telemarketers, with the exception of charities, political advertisements, and researchers. In limiting telemarketing calls, a consequence of the legislation should be increased control over fraud.

The costs of these crimes have been discussed in economic terms. It is significant, however, to note that the losses go far beyond the dollar losses experienced by victims. Anne Riordan, AARP's director of its anti-telemarketing fraud section, commented, "Telemarketing fraud isn't about money, it's about the human suffering it causes—It's life suffering." To be sure, victims will experience a great deal of pain beyond their economic losses.

### SEE ALSO

wire fraud; mail fraud; advance fee scams; credit card fraud; charity fraud.

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## Thailand

THE KINGDOM of Thailand has a long history of strong centralized rule and complicity with authoritarian figures which has increased the likelihood of corruption. Many people consider corruption to be not just pervasive but endemic throughout the entire Thai system.

In the summer of 2003, the prime minister of Thailand, Thaksin Shinawatra, following campaigns against drug trafficking and intellectual-property piracy, launched a campaign designed to eradicate "Dark Influence" throughout the country. Regional officials were instructed to draw up lists of suspected figures who would then be investigated and, if found guilty, dealt with harshly. Attention has been focused on unlicensed bus companies and motor cycle taxis, both of which are important sectors in Bangkok in particular, and both of which have reported paying bribes to the police.

The corruption that is endemic in Thai society has its roots in the feudal patronage system known as *sakdina*, in which a designated regional official was granted wide-ranging powers and discretion to administer an area, and who could reward individu-



als for their service. The legacy of this method continues to be particularly strong in the rural, agricultural areas in which the majority of Thailand's population of 70 million people live.

Thailand has a highly developed prostitution sector and this has been linked to human trafficking both into and out of the country. High profile declarations of leading massage parlor owners indicate that bribe-taking by police is widespread, while under-reporting of income has attracted the interest of revenue authorities.

Gambling is partly legalized and the underground sector is extremely large, with estimates of its annual value running at 450 billion baht (\$11 billion); this includes not just illegal lotteries but also unlicensed casinos located in border regions or river islands. These regions have also witnessed large-scale illegal logging and the manufacture and distribution of illegal drugs, often by ethnic minority people seeking funding for their struggle for independence, as in the case of the Wa in Myanmar (Burma).

The Golden Triangle includes part of northern Thailand and remains a significant producer of opium for distribution internationally. Thailand's drug problems stem from being forced to agree with the United States in 1856 to allow the importation of opium in the name of free trade.

The inability of central authorities to control actions in the regions of the country, combined with the wide-ranging powers given to regional figures, has provided numerous opportunities for graft, vote-buying and collusion between private and public figures. Both army and police officials have been implicated in these kinds of activities. Local politics are routinely run by local "godfather" figures (*chao pho*) who wield considerable influence and who have seemed able to conduct extravagant, violent lifestyles with impunity. The Thai media have yet fully to emerge from an attitude of deference and respect that hampers serious investigation and, in some cases, news executives have been associated with accepting gifts from officials to ignore potentially damaging stories.

The private sector has been quick to take advantage of shortcomings in the Thai regulatory structure and there are numerous examples of money being siphoned off from works, protection rackets, and illegal sales operations. Firearms and explosives are easily obtainable and the violent resolution of turf disputes has been common. There have also

been murders of auditors and other regulators. A great many people rely upon the informal sector of the economy and their work is therefore unregulated, and they are frequently unprotected. Reports of the mistreatment of domestic laborers emerged in the early 2000s, while the extortion of money from those wishing to work overseas has been notable for some years.

#### SEE ALSO

drug trafficking; human trafficking; corruption.

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## thalidomide

CHEMIE GRUNENTHAL, a West German pharmaceutical company, created thalidomide in 1953. It was used as a tranquilizer or sleeping pill and was being touted as a drug with no side effects. It was also used to treat morning sickness during pregnancy. With its lack of side effects, it was deemed safe enough that it did not require a prescription; therefore, it was widely available over the counter. Eventually, the German manufacturer began to license the distribution of thalidomide in other countries.

The American pharmaceutical firm, William S. Merrell Company, wanted to distribute thalidomide in the lucrative U.S. market. On September 12, 1960, the Food and Drug Administration (FDA) received a New Drug Application (NDA) from Merrell requesting approval for thalidomide. The NDA filed by Merrell contained glowing claims that the drug was safe. Animal and human tests had been conducted and there were no known problems.

And since thalidomide was already widely used all over the world, Merrell and the FDA thought the approval process would be routine. The approval was assigned to Dr. Frances Kelsey, the FDA's newest medical officer.

Kelsey reviewed the NDA along with an FDA pharmacologist and chemist. They noticed many inconsistencies with the data and omissions. Kelsey sent Merrell a letter stating that she was concerned about the testing of the drug and the many inconsistencies that were found, and more testing was needed before the FDA would grant Merrell distribution rights. Merrell was anxious to have the drug on the market and put pressure on Kelsey for approval, she declined. Meanwhile, some disturbing reports were surfacing over the drugs' side effects. Kelsey was also concerned about the drug's use by pregnant women. In the early 1960's more research was conducted on the effects of drugs on fetuses. Kelsey raised these questions to Merrell and ordered more testing. Merrell responded by putting intense pressure on Kelsey to approve the drug, but she did not yield.

Prior to the application to the FDA, in 1957, Chemie Grunenthal had early indications of the drug's dangers, as well as limited effectiveness but did not disclose these results. In fact, Grunenthal continued to promote the drug in spite of the growing number of reports of its dangerousness. Numerous women who used thalidomide during pregnancy were bearing children with extreme congenital abnormalities.

Many of the children were born with their extremities attached in odd places. Shortly after the birth defects were observed, thalidomide was banned worldwide, but it was too late for thousands of babies. An estimated 8,000-80,000 children in nearly 50 countries were born deformed because thalidomide had been marketed as being safe to use by pregnant women. Because of this, it became known as the "drug that deformed."

It was not until the considerable scope of harm being done was widely publicized that Grunenthal was forced to withdraw thalidomide from the market in 1962. Because of the various medical journal articles and news reports of the devastating effects of thalidomide and Kelsey's stubbornness for more testing by Merrell, American women and their unborn children averted tragedy. The women outside of the United States, unfortunately were not that lucky. Upon further investigation, much of

Grunenthal's behavior, prior to withdrawal of the drug from the marketplace, came under scrutiny.

Grunenthal did not have a strong reputation for thorough research. They did conduct laboratory tests of thalidomide, but the clinical trials were done by doctors on their payroll. Some of the patients experienced side effects like giddiness, nausea, constipation, and loss of feeling in their fingertips and toes. These were recorded and sent on to the company; therefore, Grunenthal had knowledge that thalidomide was not "perfectly safe" with "no side effects."

As time went on, negative reports of the drugs actual side effects began to surface. As negative reports surfaced, Grunenthal had positive reports published swiftly and attempted to discourage more negative scrutiny by exerting pressure on the medical journals not to publish such harmful reports; the drug was making them an enormous amount of money. Nevertheless, negative reports came flooding in, and with very disturbing results. Doctors, who had been told that the drug was completely safe, started contacting Grunenthal about the negative findings.

Because of the overwhelming effects of thalidomide on pregnant women and their children, the public prosecutor's office in West Germany began an investigation into Grunenthal's behavior and knowledge. Nine of Grunenthal managers were criminally tried for committing bodily harm and for involuntary manslaughter. After two-and-half years, the company agreed to an out of court settlement. The criminal hearings were suspended and Chemie Grunenthal agreed to pay 114 million marks into a victim's compensation fund, and 50 million German marks to the national government (about \$31 million).

Grunenthal was not the only pharmaceutical company sued. In Britain, thalidomide was distributed by Distillers Company Biochemicals, Ltd. (DCBL). They also advertised the drug as being completely safe, especially for pregnant women. In 1961, Dr. W. McBride of Australia discovered a direct link between pregnancy and the birth of severely deformed children.

He made his results known to DCBL, but they were ignored in Australia, nor were they passed onto their headquarters in London. It was only until McBride published his findings in *The Lancet*, a leading British medical journal, that DCBL seemed to be interested in the findings.

Even though DCBL was not the manufacturer, the many families that were affected by the drug sued the company. The lawsuits against DCBL were motivated by the need for compensation. Many of the families needed the money to help care for the children who were born with defects directly related to the use of thalidomide during pregnancy. The legal battle took 15 years to resolve. The families eventually received approximately \$33,000 each.

Early use of thalidomide across the globe had disastrous consequences. However, thalidomide has been recently resurrected. It has been discovered that thalidomide (renamed and marketed as Thalomid) is effective in treating symptoms of diseases such as leprosy and possibly AIDS. Thalomid was approved in 1998 by the U.S. Food and Drug Administration (FDA) to treat leprosy. In order to avoid tragic birth defects as in the past, the FDA has established several severe restrictions.

#### SEE ALSO

pharmaceutical industry; Food and Drug Administration; unsafe drugs.

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## Three Mile Island

THE WORST NUCLEAR accident in the history of the United States occurred at Pennsylvania's Three Mile Island (TMI) nuclear power plant in the predawn hours of March 28, 1979. The plant located approximately 10 miles south of Harrisburg,

Pennsylvania, on the Susquehanna River, came dangerously close to a nuclear meltdown that could have had devastating results.

For nearly a year, the TMI plant had been successfully producing electricity. Problems began, however, when TMI's Unit 2 Reactor was hastily opened for operation at the end of December 1987. By January 1979, Unit 2 Reactor had to be shut down for two weeks while operators identified leaks in the piping and pump system. Problems began in the pump system of the Unit 2 Reactor, specifically in the secondary loop feedwater pumps, which are responsible for turning heat and pressure from the primary nuclear sector of the plant into safely emitted steam. Due to unidentified mechanical or electronic failure, the pumps automatically shut down. Without water pushing through the secondary loop, the heat being generated in the radioactive core had no way of escaping. Thus, the water and pressure in the primary loop began to rise. A pressure relief valve opened to release the steam into a holding tank and alleviate the building pressure inside the core. The valve should have closed once the pressure decreased inside the reactor but the valve got stuck ajar. The pressure in the reactor continued decreasing as water and steam drained off the core through the opening. Further compounding the problem, the emergency water pumps, which should have immediately turned on, did not. The cutoff valves connecting the backup pumps to the rest of the system were closed days before during routine tests and never reopened. It took eight minutes for operators to notice that the valves were shut.

In the control room, an indicator light erroneously showed that the pressure relief valve had closed. Since water and steam continued to leak through the open valve, a loss-of-coolant accident was developing. Voids, or areas where there is no water present, began to form. Water was automatically and unsuccessfully redistributed to fill the voids but in the process, the pressurizer filled with water. This caused the level indicator in the control room to register that the system was safely full of water.

Operators had no idea that the pressure and water in the core were continuing to decrease, so they turned off the emergency injection water system despite the fact that the open valve was releasing water and steam. Because of inadequate cooling and the loss of water, the exposed rods warmed to



*The Three Mile Island nuclear power plant in Pennsylvania in April 1979, a few weeks after the partial meltdown. Studies are in conflict about how severely local residents were affected by the release of radiation.*

roughly 4,300 degrees, dangerously close to the 5,200-degrees meltdown point. It took almost 16 hours for plant operators to fix the valves and pumps and stabilize the temperature and pressure inside the nuclear reactor. However, one more problem had to be dealt with. A hydrogen bubble had formed above the reactor core. There was concern that the bubble would block the flow of water to the core and cause an explosion if the hydrogen were to mix with the oxygen in the water.

Five days after the chain of events began, engineers from the Nuclear Regulatory Commission (NRC) announced they had shrunk the hydrogen bubble and that the threat of a hydrogen blast had been miscalculated. It took another month before Unit 2 Reactor could be shut down completely. Three years later, the full extent of the damage was revealed when a robotic camera provided pictures of the core. Fifty percent of the core had been entirely destroyed and approximately 20 tons of molten uranium had settled on the bottom of the pressure valve.

### THE BLAME

A report commissioned by President Jimmy Carter following the incident suggests that the standards surrounding nuclear power, particularly at TMI,

had become grievously relaxed, and the associated dangers were not being taken seriously. Investigators found that the equipment, attitudes, and operating training practices of the plant's owner, Metropolitan Edison, made an accident virtually inevitable. Additionally, the report faulted human error for failing to properly connect the water pumps, neglecting to open the hand-operated valves that would have allowed the emergency water system to save the plant, and for the fatal decision to decrease water pressure to the core when the unprepared control room operators became inundated with a barrage of sirens and data print-outs.

Finally, the report placed some blame with the NRC, the watchdog agency for nuclear power plants, for failing to require replacement of the critical pressure valve that had malfunctioned 11 times before at other power plants.

In addition to the questionable professional environment surrounding the plant prior to the accident, the handling of the public throughout the course of the crisis raised some controversy. Plant officials and operators were reluctant to notify residents that a problem had occurred within the plant. A study conducted after the incident revealed that 24 percent of the sampled residents living within a 15-mile radius of TMI were not aware that anything was amiss until two days after the initial accident

had occurred. The citizens who were aware of the accident came to believe that they were intentionally misled by NRC and Metropolitan Edison.

## EVACUATION

For two days after the initial incident, residents were officially told that the situation was under control, but on Friday, March 30, they were informed, some for the first time, that the incident was not contained. Many residents were learning not only that there was an accident at TMI, but also that a hydrogen bubble had formed in the reactor's core and was threatening an explosion.

A burst of radiation had to be released into the air, thwarting an explosion by relieving the pressure building up inside the reactor. The governor advised that pregnant women and children should evacuate the area. As NRC debated on whether or not the reactor would detonate, nearly 150,000 residents chose to leave the area.

Even after area residents felt safe enough to return to their homes, many continued to live with the fear that the amount of radiation released from the plant was greater and more damaging than officials had disclosed. The degree to which the partial meltdown physically affected residents of the Three Mile Island area is still unclear. Both the long- and short-term health effects of the accident have repeatedly been researched, but often with contradictory results. A survey conducted by the University of North Carolina in 1997 examined the long-term health consequences of the TMI incident. The study found that in areas downwind of TMI, the rates of lung cancer had doubled and the incidents of leukemia were three times the national average. Meanwhile, additional research on the long-term effects was conducted by Columbia University and the National Cancer Institute which concluded that no long-term public health hazards resulted from the accident.

To further complicate the understanding of the health hazards of TMI, a re-analysis of the Columbia University data identified a relationship of heightened cancer rates across increasing levels of radiation exposure. The most recent long-term study has tracked a group of TMI area residents for 20 years and found no consistent evidence that the radioactivity released during the accident had a significant impact on the overall mortality of residents in the immediate area. The research did, however,

note a slightly elevated level in overall mortality and cancer mortality in the TMI area since 1979.

Beyond the lingering health concerns, TMI produced a wave of financial losses. Insurers for the plant's parent electric company, General Public Utilities Corp., settled lawsuits with residents tallying \$25 million. There were nearly 2,000 additional claims pending against the company until 2002 when the U.S. Third Circuit Court of Appeals dismissed all further appeals based on a lack of concrete evidence that the accident had direct health consequences. The electric company took an additional financial loss when the one functioning unit of TMI was sold for \$100 million, just one-seventh of its estimated market value.

The incident also had a significant impact on the nuclear power industry as a whole. Not one nuclear power plant was constructed in the United States since the accident at TMI to date in early 2004, and 60 other plants have been shut down or abandoned. Higher regulatory standards have been put in place, such as requiring better emergency response planning, more operator training, and general improvements in all other areas of nuclear power plant operations. Since TMI, nuclear power is no longer considered the cheap energy source of the future. It is now a more expensive option than both coal and hydroelectric power, and continues to be viewed with a wary eye.

## SEE ALSO

air pollution; Clean Air Act; Carter, James E..

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## Times Beach

ON THE MERAMEC River in Missouri, Times Beach was primarily a small resort community with a population just over 1,000 citizens. Sadly, it became emblematic of the discovery of the hazard waste problem characterizing the 1980s and, as such, was rendered a "ghost town" in the early part of the decade due to contamination by dioxin, a cancer-producing chemical.

The tortured journey for this community began when Northeastern Pharmaceutical and Chemical Company, Inc. (NEPACCO), while manufacturing hexachlorophene (an antibacterial agent), leased a production facility from Hoffman Taff. Hoffman Taff (which was later acquired by Syntex Corporation) was the manufacturer of the notorious defoliant Agent Orange created to aid ground-based troops in their combat operations in the Vietnam War. The byproducts of these production processes produced both dioxin and TCP (trichlorophenol) carcinogens. NEPACCO and Independent Petrochemical Corporation (IPC) then arranged for disposal of these wastes with Russell Martin Bliss, a St. Louis-based waste oil hauler and operator of Bliss Waste Oil Company.

Bliss mixed these chemical wastes with waste oil at his Frontenac, Missouri, facility and hauled five truckloads between February and October 1971, with each load containing between 3,000-3,500 gallons of dioxin- and TCP-laced oil. The cash-strapped community of Times Beach contracted with Bliss (for six cents per gallon of waste oil sprayed) to spray numerous roads for dust control over several miles in and around Times Beach. Bliss also sprayed the same contents on parking lots, truck terminals, several horse stables, and a horse ring owned by Bliss.

Over 40 horses died as a result of exposure to the dioxin as well as other livestock, dogs, and

birds. Several adults and children were also sickened as a result of their exposure, ranging from diarrhea, headaches, nausea, and skin lesions to hospitalizations for kidney and bladder bleeding. At least one death from soft tissue sarcoma (a rare form of cancer) was tied to dioxin exposure. In total, Bliss sprayed the dioxin-laced waste oil at 28 sites throughout eastern Missouri.

The full extent of contamination became apparent in the early 1980s as the nearby Meramec River flooded the city, further spreading the dioxin over a larger area and forcing residents to evacuate their homes. The Centers for Disease Control and Prevention recommended in December 1982 those who were evacuated be permanently relocated in what was dubbed the Christmas Message: "If you are in town it is advisable for you to leave and if you are out of town do not go back." The Environmental Protection Agency (EPA) transferred approximately \$30 million to the Federal Emergency Management Agency (FEMA) for permanent relocation of residents and businesses in 1983 (and all were relocated permanently by 1986). Those facing relocation complained bitterly about not receiving fair market value for their homes and the manner in which they were portrayed in the media as "greedy" in seeking compensation for their losses.

These events lead the EPA to place these sites on its initial National Priorities List under the provisions of the Comprehensive Environmental Response, Compensation, and Liability Act (1980). This act was designed to remedy the ravages of hazardous waste contamination common to locales such as Times Beach and Love Canal (New York) and led to an eventual cleanup funded by parties responsible for the generation and transportation of the wastes as well as the state of Missouri and the USEPA. The costs for the cleanup were in excess of \$100 million. After contentious litigation involving parties responsible for the generation and disposal of the dioxin wastes (Bliss, NEPACCO, Syntex, IPC and others) as well as citizens contesting the EPA's disposal methods and possibility of additional contamination, these wastes were incinerated in Times Beach. Although dioxin contamination was spread over numerous locations in light of Bliss spraying over such an extensive range, Times Beach was selected for the incineration site because of its small size, the largest concentration of contaminated waste, prior evacuation, and it was not yet cleaned and restored. Times Beach recently became Route

66 State Park and has been hailed as an “environmental success story” and offers visitors a history of the contamination as well as hiking, fishing, and camping. Other eastern Missouri communities contaminated by the dioxin-based materials have become upscale housing developments. However, as a legacy of its polluted past, the failure of realtors to fully disclose the extent of dioxin contamination in eastern Missouri to seven potential home buyers culminated in a jury award in excess of \$500,000.

#### SEE ALSO

Love Canal; Environmental Protection Agency.

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## tobacco industry

TOBACCO HAS BEEN around since before the United States was even a small group of colonies, but the negative health effects of tobacco remained unknown until the early 20th century. Then, articles about the detrimental health effects of smoking appeared in medical and scientific journals. A statistical correlation between smoking and cancer had been demonstrated; but no causal relationship was demonstrated until 1952 and the public remained unaware of the growing body of evidence.

*Reader's Digest* published “Cancer by the Carton,” in 1952, the first popular article dealing with the detrimental effects of smoking. The article's appearance resulted in similar reports being published in other publications. In 1953, cigarette sales decreased for the first time in more than 20 years. The tobacco industry responded in 1954 by forming the Tobacco Industry Research Council (TIRC). With advice from TIRC, the tobacco industry began marketing filtered and low-tar cigarettes that promised a “healthier” smoke. The public responded, and sales

increased again. Then in the early 1960s, the Surgeon General's Advisory Committee on Smoking and Health was formed. Initiated in response to a growing body of scientific evidence suggesting a causal relationship between smoking and cancer, and political pressure, the committee published a 387-page report in 1964 entitled “Smoking and Health.” It insisted that cigarette smoking was causally linked to lung cancer in males, and claimed that the data for women, though less complete, pointed to the same conclusion. The report noted that smokers were nine to 10 times more likely to get lung cancer than non-smokers and listed specific carcinogens in cigarette smoke, including arsenic, cadmium, and DDT.

#### DEFENSIVE, THOUGH PROFITABLE

The tobacco industry has been on the defensive (though profitably) since then. The tobacco industry was also successfully sued by the U.S. Department of Justice for engaging in a 30-year criminal conspiracy to hide information concerning the link between smoking and cancer from the public. In 1965, Congress passed the Federal Cigarette Labeling and Advertising Act requiring the surgeon general's warnings on all cigarette packages. In 1971, all broadcast advertising was banned. In 1990, smoking was banned on all interstate buses and all domestic airline flights lasting six hours or less. In 1994, Mississippi filed the first of 22 state lawsuits seeking to recoup millions of dollars from tobacco companies for smokers' Medicaid bills. And in 1995, President Bill Clinton announced plans to regulate tobacco, especially sales and advertising aimed at minors.

For decades, lawsuits from consumers went nowhere. Tobacco companies, with multiple resources for legal maneuvering, easily defeated early suits, including the first one filed in 1954. Their most serious challenge before the 1990s came in 1983, when Rose Cipollone, a smoker suffering from terminal lung cancer, filed suit against Liggett, charging the company failed to warn her about the dangers of smoking. Cipollone, who did die from smoking effects, initially was awarded a \$400,000 judgment, which was later overturned. Cipollone's family was unable to afford the cost of litigation, and abandoned the suit.

Into the 21st century, “big tobacco” faces a new legal environment. Over the past three decades, the law has changed considerably. State laws and legal



*The epitome of “cool,” Joe Camel was a character created by advertising agencies to entice market segments to smoke Camel cigarettes. The packaging on these cigarette packs is showcased like collectible trading cards for kids.*

precedents hold manufacturers more liable for the effects of their products. And the old legal defense of “contributing negligence”—which prevented lawsuits by people with some measure of responsibility for their own condition—is no longer viable in most jurisdictions. Instead, a defendant can be held partially liable and forced to pay a corresponding percentage of damages. Finally, the notion of “strict” liability has developed; this means defendants can be found liable whether or not they are found negligent. If a product such as tobacco causes harm, the company that produced it can be held responsible, even if it wasn’t aware of the potential danger.

As smoking has declined among the white non-Hispanic population, tobacco companies have targeted both African-Americans and Hispanics with intensive merchandising, which includes billboards, advertising in media targeted to those communities, and sponsorship of civic groups and athletic, cultural, and entertainment events. The sponsorship of these events and groups may mean that community leaders in minority areas are less like to speak out against the dangers of smoking.

According to the American Lung Association, smoking-related diseases take an estimated 440,000 American lives each year, including those affected indirectly, such as babies born prematurely due to prenatal maternal smoking, and some of the victims of second-hand exposure to tobacco’s carcinogens. Smoking costs the United States approximately \$150 billion each year in healthcare costs and lost productivity. These costs exceed all tobacco corporation profits and tax revenues from tobacco.

The result is that, until very recently, the costs of smoking have been socialized while tobacco profits are privatized in the hands of wealthy tobacco stockholders. The government has also granted tobacco firms some interesting forms of corporate welfare, including exporting tobacco under the Food for Peace Program, exacting trade concessions from sovereign governments that amount to forcing American cigarettes on foreign markets in the name of free trade, while the blame for tobacco related diseases and the inability to quit smoking on many people’s part is viewed as a matter of individual responsibility, or the lack thereof.



Finally, for all their talk about responsibility, the tobacco industry has actually been criminally irresponsible for decades. They have illegally smuggled an increased nicotine-level tobacco plant out of the United States, and tried to grow it in a foreign country. Tobacco firms have sanctioned the selling of cigarettes on the global black market, and have hired organized crime syndicates to peddle black market tobacco products. Tobacco executives committed contempt of Congress by lying under oath about the addictive nature of cigarettes.

The tobacco industry loses close to 5,000 customers every day in the United States alone—including 3,500 who manage to quit and about 1,200 who die. The most promising replacement smokers are young people: 90 percent of smokers begin before the age of 21, and 60 percent before age 14. To find new customers, every day U.S. tobacco companies spend \$11 million to advertise and promote cigarettes—more than the U.S. Federal Office on Smoking and Health spends to prevent smoking in an entire year.

### INTERNATIONAL SMOKING

Outside the United States, central messages about tobacco are wealth, health, consumption—in short, “USA.” In Africa, U.S. tobacco companies capitalize on this by associating smoking with affluence. It’s common to hear African children say they start smoking because of the glamorous lifestyle associated with it in the advertisements they see, hear, and

read. In emerging markets from eastern Europe to southeast Asia, transnational tobacco giants Philip Morris, RJR Nabisco, and BAT Industries aggressively hawk cigarettes with slogans associated with the American Dream; “L & M: The Way America Tastes,” “Winston: The Spirit of the USA” and “Lucky Strikes: An American Original.” These themes, and the images that accompany them, expand the appeal beyond what has in many countries been an adult male market, and has now been extended to young people and women.

Globally, per capita cigarette consumption in the developing world has increased by over 70 percent in the past quarter century. In Hong Kong, children as young as seven smoke cigarettes, and the rate of Latin American teen smoking in some cities is 50 percent. In Kenya, it was estimated in 1989 that 40 percent of primary school children smoke. And smoking rates among Korean teen-aged males climbed from 18 percent to 30 percent in a single year following the entrance of an American tobacco firm into that market.

### SEE ALSO

advertising fraud; marketing fraud; consumer deaths.

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*American tobacco companies are turning to foreign markets after more and more U.S. citizens kick the habit.*

## Toxic Substances Control Act

PASSED BY THE U.S. Congress and signed into law by President Gerald Ford on October 11, 1976, the Toxic Substances Control Act (TSCA) directed the administrator of the Environmental Protection Agency (EPA) to establish testing procedures for toxic chemicals, publicize the results of chemicals which prove to be dangerous, and to set guidelines for controlling toxic chemicals.

Legislation with a similar aim was originally proposed in 1971 by the President's Council on Environmental Quality. In one of the council's reports, a desire for substantial legislation to examine, to identify, and to regulate potentially harmful toxic chemicals was expressed. In subsequent years, the House and the Senate each passed their own versions of legislation, during both the 92nd and 93rd sessions, to address the concerns raised by the council. Disagreements resulted on the issues of chemical testing and the legislation's relationship to current regulatory laws, leading to inaction on the topic. Enactment of the TSCA finally came after there was a rise in public concern about the contamination of the Hudson River and other waterways by chlorinated biphenyl molecules (PCBs), emissions of chlorofluorocarbons (CFC), and the contamination of food products by polybrominated biphenyls (PBBs). A final version was drafted by U.S. Senator John V. Tunney of California and accepted by the majority of the House and Senate.

At first, there was a major lack of knowledge about which chemicals were toxic and about the potential effects of chemical toxicity. Therefore, the first step of the TSCA was to research and examine various chemicals in order to discover the effects of their use. Even today, the potential health and environmental effects of some chemicals which are being used daily are not completely understood.

To gain knowledge, the TSCA directed the collection of test data from different U.S. industries concerning all the chemicals that they used. Guidelines for which chemicals should be tested were set forth in the TSCA and the EPA was authorized to modify and enforce them. Companies are required to compile test data on chemicals whose manufacture, distribution, and use "may present an unreasonable risk." Testing is also required for chemicals which are produced in large amounts and if there is a possibility that some quantity of the chemical may be released into the environment or be exposed to people. Consequently, a company must compile the data and submit it to the EPA. Then, the EPA is obligated by the TSCA to require further tests if existing data does not sufficiently prove that a certain chemical is safe and if further testing is necessary to even draw conclusions.

Since there were over 55,000 chemicals being manufactured and used at the time of the TSCA's enactment, the U.S. Congress set up a special inter-agency committee to work with the EPA in deciding

which chemicals should be examined first and in coordinating the efforts of various government agencies. Every six months, the Interagency Testing Committee (ITC), as it is known, compiles a list of up to 50 chemicals and submits it to the EPA. In response, the EPA must deal with the list by returning an explanation to the ITC or calling for testing for each chemical on the list. ITC's factors for chemical selection include quantity manufactured, quantity released into the environment, number of exposures, similarity of the chemical to other known toxic chemicals, current information, and the availability of testing resources for the chemicals.

Notification of the manufacture of a new chemical within the United States by any company, except for the U.S. military which is not bound by the TSCA, is required by the TSCA at least 90 days before production begins. Also, the EPA must be informed if a company is using an existing chemical in a new way, different from the uses permitted by the EPA at that time. With this information, the EPA is able to conduct research on the new chemicals or on the new use of the existing chemicals in order to determine if the chemicals are safe. Annually, the EPA looks into more than 1,000 new chemicals submitted by companies. Interestingly, the TSCA bans the EPA from setting uniform testing procedures for new chemicals, being afraid that requirements which were too stringent would prevent companies from innovating for fear of expensive testing and possible bans on their new products.

The TSCA grants the EPA the authority to regulate toxic chemicals. The EPA may ban or limit production, specify acceptable uses, limit the acceptable concentration, require warning labels, and force companies to notify distributors and consumers of potential dangers. Also, the EPA is able to specify that companies must keep thorough records of production, plan safe disposal methods, and force the replacement or refund of products which contain dangerous chemicals.

With the company's records and the EPA's own research, the EPA maintains a massive database of all chemicals, which is required by the TSCA. Any chemical not listed in the EPA's database is considered new and must undergo the notification and research process. With the inventory and all of the EPA's toxic chemical procedures, confidentiality is considered to be very important and EPA officials are forbidden to disclose information. Doing so in serious instances may result in criminal penalties.

Since its passage, the TSCA has been modified by amendments which deal with specific toxic chemicals like radon, asbestos, and lead. Enforcement of regulations concerning these toxic chemicals, as well as all toxic chemical procedures embodied in the TSCA, is the responsibility of the EPA. Companies may have their plants inspected to verify compliance. Chemicals that have been produced illegally may be ceased in manufacture, and destroyed by EPA officials. Civil penalties for violations may result in fines as high as \$25,000 per violation each day. For violations that an individual willingly and knowingly commits, criminal penalties are possible. With strict enforcement, the EPA works to fulfill its obligations under the TSCA in order to promote the safety and health of U.S. citizens.

#### SEE ALSO

Environmental Protection Agency; water pollution; asbestos; General Electric; Love Canal; Times Beach.

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## trademark infringement

A TRADEMARK IDENTIFIES a company and its product(s) or service(s) to consumers. Trademarks that are successfully identified with a particular company may be instantly recognizable. For instance, children all over the world, even those who cannot read, know that the golden arch trademark represents McDonald's fast food restaurant.

Trademark infringement deals with commercial use of a trademark "without the consent of the owner with intent to cause confusion or to cause a mistake or to deceive." Trademark infringement may consist of reproducing, counterfeiting, copying, or deceptively imitating a registered trademark.

The infringement may occur through the use of the violating trademark in advertising, packaging, letters, websites, promotional materials, etc. Successful trademarks often imbue consumers with feelings of familiarity and confidence; therefore, when another individual or company infringes on a trademark, consumers may be misled into buying the infringer's product or service. If the product is inferior, it may negatively impact on the trademark holder's business.

#### HISTORY OF TRADEMARKS

Courts in the United States have protected the rights of patent and copyright holders since the colonial period, but trademarks were unprotected until after the Civil War. In 1870, the U.S. Congress passed the first federal trademark law, but the Supreme Court overturned it eight years later on the grounds that the law was too broad and that it was improperly based on existing patent and copyright laws. A group of interested parties formed the International Trademark Association and lobbied Congress for a new law. Congress responded with the Trade-Mark Act of 1881, which allowed trademark holders to sue for infringement but failed to clarify crucial issues of how trademarks should be defined and who had the right to claim trademark infringement.

In 1945, Representative Fritz Lanham introduced a number of bills in the House of Representatives aimed at providing adequate protection for trademark holders and clarifying the issues left hanging in the earlier legislation. The results of Lanham's efforts were synthesized in the Lanham Act, which was signed into law in July 1946. The Lanham Act, which provided the groundwork for all future trademark legislation, defined a trademark as "any word, name, symbol, device, or any combination thereof adopted by a manufacturer or merchants to identify goods and distinguish them from those manufactured or sold by others." The legislation also created a separate agency under the U.S. Patent Office to deal with the registration of trademarks and established guidelines for proving infringement of federal copyrights.

In 1988, Congress updated the Lanham Act with the Trademark Law Revision Act and changed the period of trademark protection from 20 years to 10 years, with infinite renewals. After five years, the trademark holder is required to file an affidavit

showing that the trademark will continue to be used. The name of the regulating agency was officially changed to the Patent and Trademark Office. In 1992, Congress again strengthened trademark protection with the Trademark Dilution Act, which became effective in 2000 and which stipulated that dilution of a trademark occurs when “similar trademarks are used for other products than the one registered to the trademark owner.” On March 3, 2003, in *Moseley v. Secret Catalogues* (01-1015), the Supreme Court held that it was necessary for the plaintiff to show actual proof that the trademark had been diluted rather than the likelihood that it would do so.

## TRADEMARK HOLDERS

In the United States, trademark holders may be protected from infringement by common law, state law, and federal law. To own a common law right to a trademark, a company or individual must adopt a trademark, affix it to a product or service, and use it in commerce within a restricted territory. On the other hand, trademarks that are registered in a state give the holder exclusive rights throughout the state. Federal trademarks involve trademarks that are used in interstate commerce. Individuals and companies can also file an intent-to-use trademark application with the Patent and Trademark Office.

Most trademarks are words, but they can also be logos, slogans, shapes, artistic designs, packaging, characters, graphic symbols, processes, sounds, or three-dimensional items. A company may also trademark a combination of these. A trademark containing word(s) may be an individual's name like Jean Naté, or the name of a company like Microsoft, or a “fanciful” name made up for the product like Kodak or Advil.

Fanciful names are better protected from infringement claims because they are more distinct than “arbitrary” trademarks that use an existing word like Apple Computers or Camel cigarettes. Words used in trademarks may also be suggestive like Coppertone tanning lotion. Graphic symbols like the Prudential rock or Arm and Hammer's bodiless arm wielding a hammer are so easily recognizable that no company name is really needed to identify those products.

Trademark infringement cases are often personal and highly emotional because both parties feel that their very identities are at stake, and at least

one of the parties in the suit may have spent years establishing a reputation based on the trademark. Throughout the history of trademark law, courts have been asked to decide whether infringement has occurred, whether the likelihood of confusion exists, whether the infringement was intentional, whether an infringement resulted in damage to the legal owner of the trademark, and what remedies are available when infringement is upheld. To do these things, courts have generally used The Restatement of Torts, which provides guidelines for trademark infringement based on the following tests:

*Similarity of appearance* may exist in cases such as the internationally known horseman trademark used by Polo Ralph Lauren and the double horseman trademark used by the United States Polo Association that has been challenged by Ralph Lauren.

*Phonetic similarity* was found in a suit in which Seycos watches were considered to have violated the trademark of Seiko watches because the names sounded so much alike.

*Similarity of meaning* is possible in cases like the one in which a fence company was denied the right to use the trademark Tornado because it was considered too similar in meaning to the existing Cyclone trademark for wire fences.

*Channels of trade* are used to determine if consumers might be confused by the same or similar name of a product sold in different markets. For example, both the Bigfoot trademark for snowmobile truck belts and Bigfoot for automobile tires were considered legal trademarks. On the other hand, Nutra Salt was seen as violating the trademark rights of Nutra Sweet because both products were sold to similar markets.

*Directly competitive* trademarks such as cellophane may take precedence over competitors who wish to use the term with other kinds of wrapping materials.

*Degree of care*, which is based on the level to which a consumer is committed to a product, would require that a court place more emphasis on the trademark of an automobile that cost several thousand dollars than on a bicycle that cost a few hundred dollars.

*Strength of a famous mark* gives broader protection to a nationally known trademark than to other trademarks.

Many trademark cases are settled without going to trial, and others are settled when both sides agree on a remedy. In cases that go to trial, the plaintiff

may ask for an injunction to stop the sale or use of an infringing item, and the defendant may ask for a declaratory statement to make it clear that no infringement has occurred. Successful plaintiffs may also receive compensatory and/or punitive damages and may force the cancellation of a trademark registration that is considered violative.

#### SEE ALSO

copyright infringement; forgery; capitalism; United States.

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## Truman, Harry (1884–1972)

**BASED ON HIS** early life as a Missouri farmer, cattleman, and failed investor, Harry Truman seemed an unlikely candidate for the highest political office in the United States. On April 12, 1945, Franklin D. Roosevelt (FDR, 1882–1945) died at the Little White House in Warm Springs, Georgia, after winning an unprecedented fourth term in November 1944. In that election, Truman had been on the ticket with Roosevelt for the first time. After only a few weeks as vice president and with insufficient time to settle into politics on such a large scale, Truman became the 33rd president of the United States.

One of Truman's major tasks as president was to continue Roosevelt's war on white-collar crime, particularly the ban on war profiteering and the fight against waste and corruption in government contracts. Once the war was over, Truman's Department of Justice turned its attention to policing

crimes that evolved from the Cold War. This task was made more complicated by the antics of the House Committee on Un-American Activities, which insisted that there were communists strategically placed at all levels of American government. Federal prosecutors were forced to walk a tightrope between prosecuting genuine white-collar crimes and pursuing the alleged crimes reported by participants in what became known as the Red Scare.

As the new president, Truman accepted the responsibility of leading the country through the final days of World War II and establishing the United States as the major player in a new interdependent world and serving as the guiding force of the newly established United Nations and the North Atlantic Treaty Organization (NATO). Truman's most momentous decision came early in his presidency when he made the decision to drop the atomic bomb on Hiroshima, Japan, on August 6, 1945, and on Nagasaki, Japan, three days later in order to bring World War II to a formal close.

Roosevelt was admittedly a hard act to follow, but Truman had already made a name for himself during his 10 years in the Senate through hard work and ingenuity, often bucking the political machines that ruled political parties in the 1940s. After being notified by a number of sources about the waste and corrupt practices of government contractors and subcontractors, Senator Truman managed to convince his colleagues to establish the Senate Committee to Investigate the National Defense Program, which became known as the Truman Committee that investigated the military and defense industries and ultimately saved the government over \$15 billion.

This committee became the vehicle by which Truman received FDR's attention and admiration and launched Truman as a vice presidential candidate. As president, Truman followed many of Roosevelt's plans for postwar America and adhered to almost all of FDR's plans for the United Nations. Truman did, however, develop his own leadership style and implemented new policy initiatives. In addition to his stint in Congress, Truman had served in World War I and as a judge in Missouri. This experience gave him a unique perspective on how the three branches of government worked together.

Although Truman became president through the death of FDR, in the 1948 election he was forced to run on his own record as the leader of the post-war Democratic party. When the Republican

Congress refused to implement his policies, Truman called them into special session. Truman then made their inaction a major element of his campaign. During the election, Truman promised to establish the Fair Deal policy, continuing the liberalism that had turned the country around during the Great Depression. Truman's Fair Deal consisted of over 30 propositions for government initiated reforms that centered around four major groups.

Civil Rights programs and legislation were designed to eliminate the political, social, and economic differences between races, including anti-lynching laws, fair employment and housing practices, an end to restrictions on voting, and the creation of a Civil Rights Commission to oversee implementation of civil rights programs.

Social welfare programs and legislation were intended to continue New Deal policies by passing more equitable tax laws, establishing national health insurance and unemployment compensation, and expanding coverage of social security benefits.

Housing programs were initiated in which the national government subsidized low and moderate housing to deal with the housing shortage that had emerged during World War II. Labor initiatives were directed toward raising the minimum wage from 40 to 75 cents an hour and expressing a strong opposition to the Taft-Hartley Act.

#### UNCONSTITUTIONAL ACTIONS

In June 1947, Congress passed the Labor Management Relations Act, more commonly known as the Taft-Hartley Act for its congressional sponsors, over Truman's veto. The law banned closed shops, regulated strikes, and made unions liable for damage suits incurred during strikes. In 1952, during the Korean War, Truman threatened to nationalize the railroads during a labor dispute and did seize control of the steel mills to forestall a strike in this crucial industry, acting through an executive order and ignoring the procedure for presidential intervention established in the Taft-Hartley Act. The Supreme Court found Truman's actions unconstitutional.

During Truman's second term, he also oversaw the Berlin Airlift that saved West Germany from communism, engineered U.S. entry into the Korean War, witnessed the fall of China to communism, and established American defenses to battle the Cold War which had developed as tensions with the

Soviet Union increased. Fear of communism in the United States, egged on by Senator Joseph McCarthy and his Red Scare, led to the creation of the President's Commission on Employee Loyalty and the Loyalty Oath that all government employees were required to sign, swearing that they had never been involved with the communist party in any way.

#### SEE ALSO

World War II; Roosevelt, Franklin D.; United States.

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## truth in labeling

AMERICANS DEPEND on the national government to protect them from all kinds of potentially damaging substances and devices, and one way that the U.S. Congress has dealt with this issue has been to pass a series of acts mandating truth in labeling in everything from food to drugs to cosmetics to nutritional supplements to medical devices to music to movies to books to toys to blood to electrical appliances to automobiles to industrial hazards.

The history of labeling in the United States began early in the 20th century, when, in 1907 Congress passed the Federal Food and Drug Act and gave the Bureau of Chemistry, later known as the Food and Drug Administration (FDA), the responsibility for ensuring that food products were clean and free of toxins and that medicines were safe.

Later, the government also took on the responsibility of guaranteeing that medicines and products accomplished what the manufacturers promised they would do. In the 1920s, through a series of bills, Congress called for truth in labeling in clothing with the Truth in Fabric Act. This was followed in 1938 with the Federal Seed Act, which mandated truth in the labeling of seeds and seed products, and

in 1948, by the Fur Labeling Act, calling for accurate labeling of furs and fur products to avoid misrepresentation. In the 1960s, Congress extended the truth in labeling requirements to include truth in lending, requiring that consumers be notified of specific charges, practices, and penalties when borrowing money to purchase high-priced goods.

In the wake of new attention to consumer rights, a number of government regulatory agencies announced additions to labeling requirements. Many conservatives, such as conservative economist Milton Friedman, argued that the government should not insist on labeling products because the market would take care of the problems; consumers would refuse to purchase and use unsafe products.

However, government agencies, liberals, and most consumers disagreed with Friedman, and the list of products affected by labeling requirements grew. Label requirements for packaging products was strengthened in 1964 with the Truth in Packaging Act in which Congress stipulated that package labels contain information on the weight, volume, or count of the package contents. Congress also mandated that manufacturers include a valid description of the contents of a package and include the name and address of the manufacturer on all packages.

## WARNING LABELS

In 1978, the FDA, the U.S. Department of Agriculture, and the Bureau of Consumer Protection of the Federal Trade Commission (FTC) held five joint hearings around the country to ask consumers what information they saw as necessary for food labeling and how they felt it should be presented. The hearings produced over 900 oral commentaries and 9,000 letters. An additional two-day hearing generated another 2,000 comments. Subsequent meetings were also held in 1980 and 1981. Overwhelmingly, consumers wanted information that helped them make decisions about products and called for warnings against harmful products.

Reacting to consumer concerns, the U.S. government has given a number of government agencies the authority to oversee the practice of labeling to help consumers make wise decisions about products they commonly use. The FDA oversees labeling on foods, drugs, cosmetics, veterinary products, medical devices, biologics, and radiation-emitting products. The National Toxicology Program works

with the FDA to identify potential toxins. The FTC is charged with oversight of truth in labeling and advertising. The Bureau of Alcohol, Tobacco, and Firearms guarantees truth in labeling of alcohol products. The Consumer Products Safety Division (CPSD) has oversight of most other products, including those commonly used in households such as baby toys or electrical appliances. The Food Safety Inspection Service (FSIS) under the direction of the Department of Agriculture has oversight responsibility for agricultural products.

There are four kinds of labels commonly used to convey information to consumers: content labels, which often contain messages about harmful ingredients such as tar or nicotine, but may also simply inform the consumer about the ingredients in the product such as the nutritional value of food or the fiber content of clothing; informational labels, which tell the consumer how to use a product and identify the possible dangers of misuse, such as using an electrical product around water; warning labels, which caution individuals about possible side effects of using the product as with some medications, or, in some cases, advise the use of protective clothing or conditions of use, such as using certain products only in well-ventilated areas; quality labels, which convey comparative information, such as "prime choice" or "irregular" on meat and clothing respectively.

The medium that is used to convey the message of the label has much to do with how well the consumer receives the message. For example, a consumer may be more likely to read large print than the fine print on the outside of a package, or a consumer may be more inclined to read information placed directly on the label of a medicine bottle than to read the details included on a prescription insert.

While a number of big businesses have continued to fight truth in labeling since its inception because of enormous costs involved in labeling and the loss of profits from unsafe or unwise products, numerous studies have documented the effectiveness of product labeling.

## SEE ALSO

False Claims Act; Food and Drug Administration; Federal Trade Commission.

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Product Labeling and Health Risks," *Product Labeling and Health Risks* (Cold Spring Harbor Laboratory, 1980); Ira Sager, "The Price of Safety," *BusinessWeek* (September 15, 2003).

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## Truth in Lending Act

ON MAY 29, 1968, the U.S. Congress passed the Truth in Lending Act (TILA), Public Law 96-32. TILA was designed to promote economy stability by protecting the credit rights of consumers. Provisions of the act apply to individuals and businesses that on a regular basis offer and extend credit involving finance charges to individuals, families, or households. Credit extended for business and commercial activity and to security and commodities accounts are not covered by TILA. Loans in excess of \$25,000 and public utility tariffs are excluded.

The bill came in response to lobbying by consumer groups and the realization that consumers were spending millions of dollars every year in unsuccessful efforts to deal with unfair credit practices. It was understood that in their quest for ever-increasing profits, creditors often ignored the concept of consumer rights. The Federal Reserve and the Federal Trade Commission (FTC) were given the power to enforce provisions of TILA. At the urging of consumer advocate Ralph Nader, Congress created the Consumer Protection Agency in 1971. This agency has the authority to oversee all activities concerned with protecting the rights of consumers. In addition to federal regulations, each state retains the right to establish laws and restrictions concerning interest rates and credit conditions.

Terms of the Truth in Lending Act require timely public disclosure of credit terms in language that consumers can understand. Before the TILA was passed, it was common practice for terms of credit to be placed in fine print and/or in highly legal terms that obscured the real terms of extending credit. The result was often high interest rates and unexpected finance charges for the consumer. Section 106 A of TILA mandates that the amount of finance charges shall be determined as the sum of all charges paid by the consumer. These charges in-

clude interest rates, time price differentials, point discount amounts, and other charges included in the loan. Service and carrying charges, finder's fees, credit report charges, and insurance payments are also covered by TILA disclosure requirements.

The Truth in Lending Act spells out specifically what must be included in information given to the consumer at the initial transaction and with each billing. Initially, the creditor must explain all finance charges, dates of accrual, billing cycles, conditions of charges, and use of additional charges. TILA also requires that the consumer be given a statement of consumer rights and information about resolving disputes. In periodic statements, the creditor must inform the consumer of the outstanding balance at the beginning of the billing cycle, amounts, and dates of any additional transactions, the total amount credited through payment or billing errors, itemized explanation of all finance charges, and the balance at the end of the billing cycle.

Credit extended through the use of credit cards is also restricted by TILA. In that instance, the creditor must detail the liability to the consumer for any unauthorized use of the credit card. Fraudulent use of credit cards in excess of \$5,000 is punishable by fines up to \$10,000 and imprisonment for up to five years or both.

The architects of the Truth in Lending Act recognized that consumers sometimes change their minds. In the case of a home improvement loan not covered by a first loan or mortgage, the consumer may withdraw from the loan within three working days. Truth in advertising credit was also covered under TILA. Creditors are bound to disclose the amount of the required down payment, the amount and due dates of payments, and the true annual percentage of finance charges.

Other provisions of TILA provide the consumer with the right to bring civil charges against creditors who do not comply with truth-in-lending law. Consumers have the right to collect damages up to twice the amount involved in the transaction. When credit abuse identified under TILA is extensive enough to warrant a class-action lawsuit, the creditor may be found liable up to \$500,000 or one percent of net worth, whichever figure is lesser. The creditor may also be required to pay all court and legal costs. In some cases, the creditor is able to show that the illegal conduct was unintentional and that corrective measures have been initiated. In



cases of criminal liability, the creditor can be fined up to \$5,000, imprisoned for up to one year, or both.

The Fair Credit Billing Act of October 29, 1974 amended the Truth in Lending Act to give consumers greater protection by providing a legal platform for complaints and requiring creditors to disclose all billing complaints. In the 1970s, other Congressional efforts to protect the credit rights of consumers included the Fair Credit Reporting Act of 1979, the Equal Credit Opportunity Act of 1975, the Consumer Leasing Act of 1976, and the Fair Debt Collection Practices Act of 1977. Additionally, Congress has frequently extended truth-in-lending consumer protections through updated legislation.

#### SEE ALSO

bank fraud; credit card fraud; advertising fraud.

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## Tyco International

IN 1960, Tyco was established by Arthur J. Rosenberg, who started it as an investment and holding company in Waltham, Massachusetts (not be confused with the Tyco Toy, Inc., the well-known toy company). The company had two main holdings: the Materials Research Laboratory and Tyco Semiconductor. The company's primary function was performing experimental research for the government sector.

In 1962, Rosenberg incorporated the business, changing its name to Tyco Laboratories and merging Tyco Semiconductor and the Materials Re-

search Laboratory. After the merger, Tyco still relied heavily on U.S. government research contracts. The main concentration of the company soon changed, from governmental research to the commercial sector, for which high-technology materials as well as science and energy conversion products were produced. As the company grew, it became public in 1964, and its expansion continued.

Tyco again altered its focus, and in 1965, it started to purchase other companies to meet its development and distribution network needs. It was during this phase that Tyco's purpose morphed into the manufacturing of industrial products. By 1968, a total of 16 companies had been acquired by Tyco Laboratories.

During the period of 1973-82, the company continued to experience tremendous growth through the acquisition of even more affiliated businesses. In 1974, Tyco's stock was listed on the New York Stock Exchange, and by 1982, its sales exceeded \$500 million and its net worth surpassed \$140 million. In 1976, the company hired L. Dennis Kozlowski. Major acquisitions of the company during this period included Simplex Technologies (1974); Grinnell Fire Protection Systems (1976); Armin Plastics (1984); and Ludlow Corporation (1981).

Between the years of 1986 and 2000, many significant changes occurred, including a name change from Tyco Laboratories to Tyco International Ltd. in 1993, which was a reflection of its increasingly global presence. These changes set the stage for the company's four business segments: electrical and electronic components, healthcare and specialty products, fire and security services, and flow control. Kozlowski became the company's chief executive officer (CEO) in 1992.

Tyco continued to experience success, attributed in part to the business practices of Kozlowski. In 1999, the Securities and Exchange Commission (SEC) initiated an inquiry into Tyco's practices, resulting in a restatement of Tyco's earnings in 2000. The SEC abandoned its probe in July 2000, and the company boasted revenues in excess of \$6 billion for fiscal year 2001. In January 2002, the bright picture changed when its many questionable accounting practices were revealed, adding the name Tyco to a series of corporate crime scandals. It was during this time that Tyco posted a negative cash flow, and subsequently set a plan to break into four companies. This plan was deserted in April, during the

course of an investigation by the Manhattan, New York City, district attorney's office.

The investigation revealed Kozlowski's involvement in many questionable activities, such as a \$19 million, no-interest loan from Tyco in 1998, which the company forgave as part of a special bonus program. Tyco also covered Kozlowski's income taxes on the forgiven loan, which amounted to \$13 million. Kozlowski's extravagant lifestyle, financed by Tyco, included multiple estates in Nantucket, Massachusetts, Rye, New Hampshire, and Boca Raton, Florida, as well as lavish parties, a 130-foot racing yacht, and charitable donations with company funds in Kozlowski's name. Estimates indicated that Kozlowski financed these activities by looting over \$75 million from Tyco; none of this was made public to the company's shareholders.

Kozlowski resigned on June 2, 2002, and the following day, charges of evading more than \$1 million in New York state sales taxes on art were filed against him. In September 2002, the SEC filed a civil enforcement action against Kozlowski and two other top executives, charging that they failed to disclose the multimillion dollar, interest-free loans from Tyco. Kozlowski's trial resulted in the most serious charges being dismissed, with a mistrial declared on the larceny charge. Expecting a retrial, and in an unusual situation, he has asked that his trial on state charges of sales tax evasion be combined with his federal larceny trial.

#### SEE ALSO

accounting fraud; embezzlement; fiduciary fraud; forensic auditing; Enron Corporation.

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## tying arrangements

A TYING arrangement is an agreement by a party to sell one product or service only if the potential

buyer: a) also purchases a different product or service, or b) agrees she will not purchase that product or service from another seller. The item the buyer wants to buy is the tying item, and the one she is required to buy in order to get it is the tied item.

A Louisiana hospital required that all surgical patients use the services of one of four anesthesiologists. A competing anesthesiologist charged that this violated the Sherman Antitrust Act, which "prohibits contracts, combinations, and conspiracies in restraint of trade, and monopolization, [and] includes criminal penalties when enforced by the government. Violation can result in substantial fines and, for individual transgressors, prison terms." The U.S. Supreme Court's 1984 decision that this case did not represent an illegal tying arrangement was based on the hospital's lack of dominant position; it only housed 30 percent of the area's hospitalized patients. If a patient did not want to use any of the four anesthesiologists, he could easily go to another hospital.

For many years prior to this *Jefferson Parish Hospital v. Hyde* decision, federal courts had considered tying arrangements to be illegal *per se*, that is, automatically illegal. However, in that landmark decision, five justices retained the traditional *per se* rule but only if an analysis of the market affected by the tying arrangement indicated a "substantial potential for impact on competition." The other four justices were in favor of abandoning *per se* altogether. Associate Justice John Paul Stevens said in the majority opinion that "there is nothing inherently anticompetitive about packaged sales." He went on to say that to have a tying arrangement, there must be two products with distinct markets, and the seller must have sufficient market power for the first product to compel the customer to buy the second product.

The key is the market power. A company that only holds a small share of market for a product or service will not endanger other companies, products, or consumer resources by tying its product or service with another. On the other hand, a company that has a large portion of the market would be much more likely to run afoul of illegal tying charges because consumers would have much less recourse, or other products to choose instead. Because of the actual market conditions and required effect on commerce, each case must be studied on an individual basis. A classic example of a tying arrangement involves Sandoz Pharmaceuticals. The company manufactured Clozaril, which is used in

treatment of schizophrenia, and required that the medicine be bought only as a package with an expensive blood-monitoring system and lab-testing services operated by Caremark, Inc.

It was ruled that this was an illegal tying because, although Clozaril patients should have their blood monitored for side effects, those side effects were rare. More importantly, the tests could be performed more quickly and equally effectively by personnel by any hospital or laboratory service provider.

Tying arrangements, which can seriously damage competition, have been associated with many products and services. Charges of illegal tying have been filed in such diverse areas as photocopiers,

computer software and systems, games, and banking services.

SEE ALSO

antitrust; Sherman Antitrust Act.

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# U

## unfair trade practices

UNFAIR trade practices involve a set of activities that involve one economic actor taking actions that are not consistent with the conditions of free market trade, thus obtaining or hoping to obtain an advantage over competitors. Unfair trade practices are related to but separate from both predatory practices, which involves the exploitation of weaker parties with partial access to information and marketing fraud, which involves making false promises about goods and services. However, there are considerable areas of overlap between the different sets of activities.

Unfair trade practices may be divided into the micro level, which concerns the activities of individual firms, and the macro level, which concerns activities at the industry or state level. In both cases, awareness of unfair trade practices and pressure applied to prevent them has intensified considerably in recent years as concerned people have been able to distribute information and organize protests much more efficiently through the use of the internet and mobile telecommunications technology. This, combined with the significantly reduced costs of international travel, have greatly raised awareness of global inequities and public sentiment has turned against the corporate sector in many cases because of high-profile financial scandals and the

payment of huge salaries and bonuses to executives, seemingly irrespective of corporate performance.

### MICRO LEVEL

There is a wide range of activities that may be classified as unfair trade practices at the micro level. They include espionage and theft of intellectual property, deliberately breaking business contracts or signing them without intending to adhere to them, or in some other ways undermining the competitive positions of other organizations. The point at which trade practices change from being intensely competitive to being unfair is, of course, difficult to define as it is likely to vary in most cases, and to appear differently to each participant.

For example, the growth in power of large retailers, like supermarket chains, has enabled them to apply considerable pressure on their suppliers to provide fruit and vegetables of regulation size and shape and at ever lower prices. These practices are regarded by the farmers as unfair but by the retailers as a legitimate use of market power to obtain a competitive advantage. Additional activities in which firms might indulge include the attempted creation of monopolistic conditions, discriminatory pricing, and dumping. Monopolistic competition or the attempts to create it may be countered by the use of antitrust legislation in whatever mani-

festation it appears in a particular country. Discriminatory pricing refers to charging different prices to sets of consumers based on criteria that do not conform to free trade principles. Dumping is a type of discriminatory pricing, in that prices in some export markets are set very low, possibly under the costs of production, so as to undermine the position of domestic competition. Accusations of this practice may be referred to the World Trade Organization (WTO). The tactic may also be employed within a domestic market when one or more products in a product line may be offered at a very low cost in the effort to obtain market share.

### MACRO LEVEL

At the macro level, unfair trade practices involve such activities as barriers to entry into the home market, the imposition of taxes and tariffs on a discriminatory basis, and the creation of industry-wide cartels and consortia designed to maintain prices at high levels or else to extract an excessive amount of profit from customers. Perhaps inevitably, many of the practices of this kind are subject to being contested on political grounds, in that governments may plead special circumstances in protecting their own industries, or else that barriers to entry are simply health and safety standards. Examples of this include the insistence by the Korean government that all products imported into the country be packaged wholly in the Korean language and the European Union's (EU) refusal to accept some imports of Thai shrimps on the grounds of possible chemical contamination.

The use of government trade diplomacy in promoting home interests in export markets is also a potential source of contest unfair trade practices. Pressures to conduct these activities are intensifying in some respects because of the increasing need for competitiveness in markets in which large pools of cheap labor are becoming more active and important and states look to compete with each other more directly. Generally, international trade practices are regulated by the WTO, which seeks to act on a multilateral basis in resolving conflicts.

### SEE ALSO

illegal competition; tariff crimes; globalization.

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## Unilever

UNILEVER IS A Dutch-Anglo global company specializing in consumer goods, essentially food and personal care products. Unilever proclaims that every day 150 million people are choosing their brands "to feed their families and clean their homes." Its products are sold in over 150 countries and the company has annual sales of approximately \$46 billion. Unilever controls subsidiaries in at least 90 countries and has 295,000 employees (2000).

In spite of Unilever's vast size and presence worldwide, the company's actual visibility is cloaked into appearing relatively small since Unilever does not retail under its own name. The global company creates loyalties to various brand names in various markets. One of the keys of its winning strategy is a substantial dependence on advertising.

Unilever distributes its products all over the world, especially in Europe, the United States, South America, and Asia. Among them are prestigious brands, such as Magnum and Solero and Ben & Jerry's (ice cream). Other recognizable goods are labeled Dove and Lever 2000 (soaps), Gorton's (frozen meals), Slim Fast meal replacement drinks, Lipton (teas), and Vaseline, among the 400 brands the company controls. Shares of Unilever are available for trade in the Netherlands, France, Germany, Great Britain, the United States, and Switzerland.

Unilever has strong ties with the third world thanks to the operation of plantations and agricultural experiments it has carried out in cooperation with national governments. It uncompromisingly controls the virtual food chain. For example, tea is the result of Unilever's agricultural and economic systems in the web of supply and demand worldwide. As a true transnational giant, Unilever has been criticized over time at different levels. For example, in the promotion of its products, Unilever

tries to bring as many products as possible to the market without necessarily examining the consequences. The Advertising Standards Authority (ASA) ruled that Unilever misled British consumers in the way the company presented the health benefits of its cholesterol-lowering margarine, Flora pro-activ.

Unilever was accused by Greenpeace of double standards and shameful negligence for allowing its Indian subsidiary, Hindustan Lever, to dump several tons of highly toxic mercury waste in the densely populated tourist resort of Kodaikanal and the surrounding protected nature reserve of Pambhar Shola, in Tamilnadu, southern India.

According to Corpwatch, a corporate watchdog group, "In March 2001, residents of Kodaikanal caught Unilever red-handed when they uncovered a dumpsite with toxic mercury-laced waste from a thermometer factory run by Hindustan Lever. The 7.4 ton stockpile of crushed mercury-containing glass was found in torn sacks, spilling onto the ground in a busy scrap yard located near a school."

Corpwatch further states: "Unilever's actions in Kodaikanal violated several United Nations Global Compact principles. Some of their actions, such as the closure of the factory, may appear to be in line with responsible behavior. However, these actions were taken only after the community exposed Unilever's wrongdoings."

Unilever's chief executive officer admitted unethical business practices, confirming the use of "sweeteners" or "facilitation payments," used by local management administration in approximately 90 countries, to seal business deals.

#### SEE ALSO

bribery; corporate criminal liability.

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## Union Carbide

THE U.S.-BASED chemical company, Union Carbide Corporation, a wholly-owned subsidiary of Dow Chemical Company since 2001, is linked in the minds of many to the 1984 Bhopal disaster. Just after midnight on December 3, 1984 methyl isocyanate gas leaked from a tank at a chemical plant in Bhopal, India, that was owned and operated by Union Carbide India Limited, a joint venture between Union Carbide and a group of Indian companies.

According to the state government of Madhya Pradesh, approximately 3,500 people died, 40 people experienced permanent total disability, and 2,680 people experienced permanent partial disability. The Bhopal People's Health and Documentation Clinic maintains that 8,000 people died in the immediate aftermath of the incident; other estimates range higher as well. Although the number of people killed and injured is disputed, most commentators agree that the Bhopal disaster is the world's worst industrial disaster to date.

The Bhopal disaster has come to dominate popular memory of Union Carbide, obscuring the history of the company prior to the date of the disaster. Although the Union Carbide and Carbon Corporation did not exist until November 1917, its origins date to the formation of the Union Carbide Company to manufacture calcium carbide for acetylene and carriage lamps in 1898. A period of tremendous growth followed, but was soured by events at Hawk's Nest, West Virginia during the late 1920s and early 1930s.

Approximately 700 people died from acute silica poisoning contracted during the construction of a tunnel for a hydroelectric power project near Hawk's Nest, Virginia in 1930. Union Carbide conceived the project in 1927, contracting the construction work to Rinehart and Dennis and forming the New Kanahwa Power Company to operate the hydroelectric plants. Union Carbide engineers directed the work carried out by Rinehart and Dennis, which employed the construction workers. Many of the workers contracted silicosis after inhaling rock dust containing silica while clearing the tunnel of blasted rock.

In 1932 lawyers began legal proceedings on behalf of several of the workers with local residents testifying that the workers left the site covered in dust. The courts ruled in favor of compensating the

workers. However, the court cases were settled out of court after the victims' attorneys received secret payments to take no further action.

During the 1940s, Union Carbide played an important role in the U.S. war effort, producing butadiene, styrene and polyethylene; mining and refining uranium; and contributing to atomic weapons research by operating the Oak Ridge, Tennessee, facilities for the U.S. government. In 1970 the world's largest mercury spill occurred at the Oak Ridge plant. Union Carbide used large quantities of mercury in the weapons work. In 1982 health officials warned that fish from an Oak Ridge creek should not be eaten because of high levels of mercury left from a spill in 1966. The following year a declassified report revealed that Oak Ridge plants released an estimated 2.4 million pounds of mercury from the 1950s to the mid-1960s.

By 1984 Union Carbide's fortunes were improving as the global economy recovered from the effects of the 1970s oil shocks. The company was well respected within the chemical industry and operated 1,200 sites around the world.

## THE BHOPAL DISASTER

Union Carbide had a long history in India before the Bhopal disaster, opening its first plant, a battery-assembly unit near Calcutta, in 1924. In 1975 the government of India granted Union Carbide a license to manufacture pesticides, which played an essential role in attempts to increase Indian agricultural productivity. Union Carbide and a group of Indian companies formed Union Carbide India Limited (UCIL). This joint venture company was to construct and operate the pesticide plant in Bhopal, Madhya Pradesh. The plant used methyl isocyanate (MIC) to manufacture sevin carbaryl and several other carbamate pesticides. Sometime during the third shift on the night of December 2, 1984 a large quantity of water entered Tank 610. The water reacted with the MIC leading to a rapid increase in temperature and pressure inside the tank. A pressure release valve on the tank blew open, and 41 tons of MIC gas were released into the atmosphere, killing thousands and injuring thousands more in residential areas downwind of the plant.

In the immediate aftermath of events at Bhopal, the media attributed the incident to improper washing of a pipe in the MIC manufacturing unit. It emerged that a worker cleaning pipes in the MIC

manufacturing unit on the day of the incident failed to isolate the section of pipe he was cleaning by inserting a metal slip blind. This account portrayed the plant as poorly run, an impression reinforced by increasing revelations about malfunctioning pressure gauges and thermometers, and the parlous state of the plant's safety system.

The cooling system was not working and the vent gas scrubber was turned off for maintenance, as was the flare tower. It also emerged that a team of Union Carbide engineers inspected the Bhopal plant and indicated that it was unsafe in May 1982. In their Business Confidential safety audit the team identified "61 hazards, 30 of them major and 11 in the dangerous phosgene/MIC units." When it became known that Union Carbide was planning to sell its Indian chemicals and plastics businesses before the incident, there appeared to be a commercial reason for the company's apparent lack of concern about rectifying health and safety issues at the plant.

## SABOTAGE OR NEGLIGENCE

The government of India and Union Carbide investigated the incident independently. The official investigation plumped for the water-washing theory and placed the blame for the incident firmly on the shoulders of UCIL, while Union Carbide attributed the incident to employee sabotage and later to a Sikh terrorist group known as Black June. Although the Union Carbide team accepted that the entry of water into Tank 610 caused the leak, the team attributed this to deliberate sabotage, not improper washing of a pipeline in the MIC unit.

The government of India did not share this interpretation of events and sought compensation from Union Carbide. In 1985 the government passed the Bhopal Gas Leak (Processing of Claims) Act making the government the sole representative of the victims and their relatives in dealings with the company. India proceeded to file a civil suit against Union Carbide in a U.S. federal court, seeking \$3 billion in compensation. The U.S. court sent the case back to the Indian courts in May 1986. Meanwhile, Bhopal District Court ordered Union Carbide to pay \$190 million in interim relief to Bhopal victims.

The Jabalpur High Court upheld the court order after hearing a Union Carbide appeal. In February 1989, the Supreme Court of India ordered Union Carbide and UCIL to pay the government of

India \$470 million and \$45 million in compensation for Bhopal, settling all litigation relating to Bhopal. The court also quashed all criminal proceedings relating to the incident. In January 1990, the government of India announced it would support victims' attempts to have the Bhopal settlement set aside. Almost two years later, the Indian Supreme Court revoked the criminal immunity granted to the company and its officers. Attempts to bring Warren Anderson and other former executives to trial continue as do efforts to set aside the 1989 settlement.

It is arguable whether Union Carbide ever truly recovered from Bhopal, and the weakened company merged with a subsidiary of Dow Chemical Company in 2001, becoming a wholly owned subsidiary. Dow maintains that the company did not inherit an outstanding liability for the Bhopal disaster despite being the focus of lobbying by Bhopal survivors. However, Dow inherited several other liabilities from Union Carbide, including responsibility for asbestosis and environmental damage.

The U.S. authorities were slow to learn the lessons of Bhopal until a small amount of MIC gas leaked from a Union Carbide plant in Institute, West Virginia, in August 1985. This awakened the American public to the possibility of an incident similar to Bhopal occurring in the U.S. The Environmental Protection Agency (EPA) responded to these concerns by establishing the voluntary Chemical Emergency Preparedness program to encourage state and local authorities to identify hazards and plan for emergencies in their area. In 1986 Congress incorporated many of the elements of this program in the Emergency Planning and Community Right-to-Know Act of 1986, also known as Title III of the Superfund Amendments and Reauthorization Act.

The chemical industry also took steps to prevent another major release of toxic gas and repair the industry's public image. The U.S. Chemical Manufacturers Association (CMA) initiated a Responsible Care initiative in 1988. The initiative was an attempt to improve the safety and environmental performance of the U.S. chemical industry and thus improve the public image of the U.S. chemical industry after Bhopal.

#### SEE ALSO

India; corporate criminal liability; negligence.

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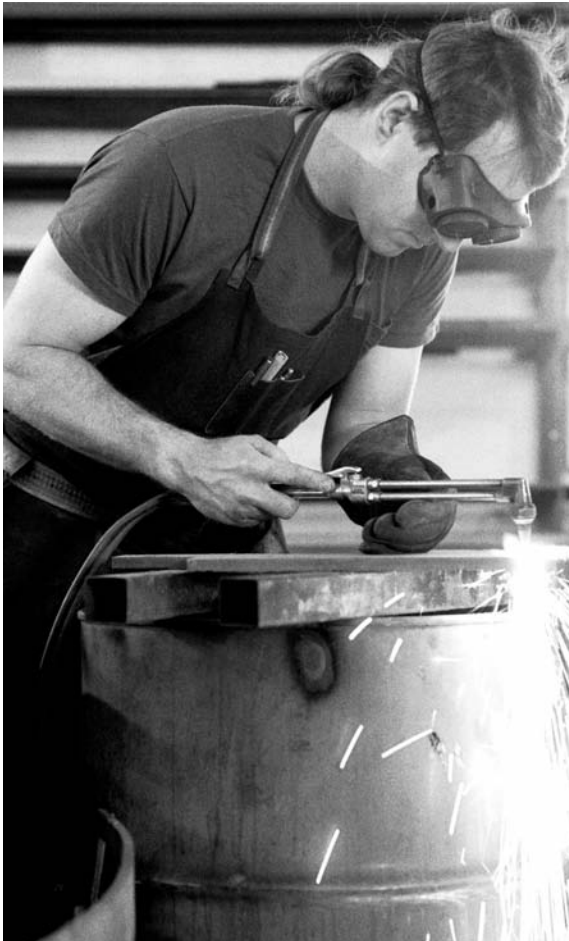
## unions

UNIONS ARE constituted for the aim of collectively negotiating with employers over wages, hours and other terms and conditions of employment. Throughout their history, labor unions have been both perpetrators and challengers of corporate crimes. In his division of corporate crime into white-collar and occupational crimes, Clinard Marshall describes occupational crime as that "committed largely by individuals or small groups of individuals in connection with their occupations. It includes violations of the law by businessman, politicians, labor union leaders, lawyers, doctors, pharmacists, and employees who embezzle money from their employers or steal merchandise and tools."

On the other hand, he also states that corporate crime is indicative of the power relations in our societies and that laws on such crime indicate the influence of big corporations on legislation. It is in this context that unions, together with other interest groups, can challenge illegal corporate activities such as the disregard of workers' safety. The intervention of unions is particularly necessary given the failure of big business to act sufficiently to assure the health and safety of its workers.

Without the pressure of unions for labor legislation, workers could still be paid according to what corporations deem appropriate and working conditions could be more dangerous. In the context of global capitalism, many scholars and economists agree unions are a much needed corrective to the general profit motive.





*Despite ties to organized crime and politics, unions have protected the safety and wages of American workers.*

As an assistant attorney general put it: “In these times, when important and far-reaching questions are being raised about the ethics of the business community, strong and eloquent voices urging responsible business behavior are vitally needed.”

## ORIGINS AND SCOPE

The concept of labor unions developed in Europe at the time of the Industrial Revolution, when agricultural activities declined and employment began to move to urban and industrialized areas. An increasing number of people left farming and started to work for employers, often in hideous conditions and for very low wages. The labor movement arose as a result of the disparity between the power of

employers and the powerlessness of individual employees. Predictably, employers did not welcome the appearance of unions on the labor scene. Labor unions were illegal for many years in most countries. There were severe penalties for attempting to organize labor unions, including execution and deportation. However, such an attitude proved, in the long run, to favor rather than hinder the development of labor unions. To quote just one of the most famous examples of this trend, in 1834, six British men from Tolpuddle in Dorset were arrested and deported to Australia for the founding of the Friendly Society of Agricultural Laborers. Yet, they soon became popular heroes and were released two years later with the help of Home Secretary Lord John Russell. Their fame has survived to this day and many memorials and events still celebrate the six Tolpuddle Martyrs as they have become known in labor history.

Labor unions soon developed into important political entities which eventually managed to get approved a body of labor law legalizing organizational efforts and codifying the relationship between employers and those employees who are members of labor unions. Yet, both the function of labor unions and the extent and effectiveness of labor legislation vary greatly from country to country. In Europe, unions have played a greater role in management decisions through participation in corporate boards, while in the United States this practice started later and is still limited. To many, the appointment of union officials to boards of directors is an effective countermeasure to corporate crime. Yet, not everyone believes that union board members will necessarily exhibit greater responsibility than business members. What mainly affects the roles of the unions is the structure of employment laws. In many European countries, wages and work contracts are largely negotiated through governmental action. The American approach, on the other hand, derives from theories of *laissez-faire* capitalism and while, setting some minimum standards, it leaves most workers' salary and benefits to collective bargaining and market forces.

## POLITICS AND UNIONS

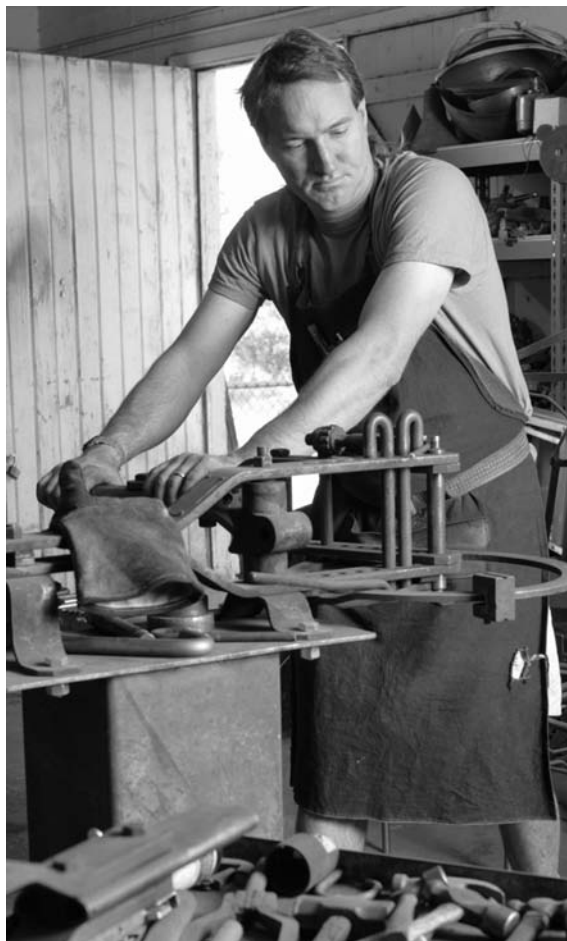
Unions have also very different relationships with political parties in different countries and such relationships are constantly changing. In many European countries unions were, in the past, integrally

associated with a particular political party. During the Cold War era, for example, in countries which had a strong communist party such as Italy and France, trade unions soon split according to their ideological allegiances. In Italy, critics of the leftist union CGIL considered it as the “conveyor belt” of the politics of the Italian Communist Party. In France, in 1948, a group of the leftist union CGT founded the union Force Ouvrière, denouncing the dominance of the French Communist Party within the CGT. With the disappearance of the two contrasting blocks of the Cold War and the definition of a more moderate agenda for the Left, the relationships between unions and parties has turned out to be more fluid. Even in a country like the United Kingdom, where the labor movement has always been an integral part of the Labor Party, this relationship frayed as Prime Minister Tony Blair’s New Labor embarked on privatization plans considered irreconcilably at odds with labor’s interests.

In the United States, by contrast, while the labor movement has traditionally been aligned with the Democratic Party, labor unions have not been monolithic in their alliances. The International Brotherhood of Teamsters, the big union that was headed for two decades by Jimmy Hoffa, supported Republican Party candidates on a number of occasions. The Professional Air Traffic Controllers Organization endorsed Ronald Reagan in 1980, only to see the president banning all of its striking members from employment the following year.

Images of corruption and crime have also been widely associated with unions in the American collective mind. While efforts were made throughout the 19th century to establish unions, religion, race, ethnicity and gender acted as divisive forces. The early American craft unions founded in the 1820s and 1830s had characteristics more similar to medieval guilds than to modern trade unions: membership, which was refused to women and African Americans, was conceived as a way to avoid the competition of inferior workmen due to the regulation of apprenticeship and the establishment of minimum wages.

Craft unions soon started to gather in umbrella organizations such as the National Trades Union, but the high unemployment and the wage cuts that characterized the late 1830s and early 1840s led to the collapse of the movement. This pull of organization and disorganization was constant throughout the century, making the presence of trade unions in



*Union membership steadily declined in the late 20th and early 21st centuries as corporate strengths have grown.*

American life extremely weak: only 2 per cent of the total labor force and less than 10 per cent of all industrial workers, were members of unions. Nineteenth century middle-class Americans saw workers’ organizations with suspicion.

## AMERICAN UNIONIZATION

In 1881, the Federation of Trades and Labor Unions was founded, and five years later the organization changed its name to the American Federation of Labor (AFL). The AFL’s first president was Samuel Gompers, who held fairly conservative political views and believed that trade unionists should accept the capitalist economic system. The membership of AFL consisted of about 140,000

workers, most of them skilled and native-born. Gompers purposefully avoided the rhetoric of workers' solidarity and pushed instead for concrete targets such as higher wages, shorter hours and the right to bargain collectively. Gompers's deputy gave an effective view of the AFL stating that they had no ultimate ends, but were fighting only for immediate objects, "objects that can be realized in a few years." In contrast to earlier workers' organizations such as the Knights of Labor, the AFL accepted industrialism and worked to improve working conditions. Though AFL memberships grew steadily under Gompers' leadership, the union suffered several setbacks in the 1890s due to the outbreak of labor violence, especially in the railroad industry.

In 1905, representatives of 43 groups, who opposed the policies of American Federation of Labor, formed the radical labor organization, the Industrial Workers of the World (IWW). The IWW, whose motto was "An injury to one is an injury to all," shared the Knights of Labor's aim of seeking to unite all workers, including the unskilled who were barred from craft unions. Yet, its members, known as "Wobblies," were more radical than most Knights of Labor: they clearly supported socialism and employed tactics of sabotage. The Wobblies used the rhetoric of class conflict, "The final aim is revolution," to convey their belief that workers should run national industries.

Mary Harris, better known as "Mother Jones," fought against the exploitation of workers in mines and helped miners to organize. Many members and leaders of the Industrial Workers of the World were harassed by the police and suffered legal prosecutions. Mother Jones was arrested following the strike in Paint Creek, West Virginia. During the strike, men employed by the mine-owners opened fire against the strikers and their families.

When a company guard was murdered, Jones, then age 78, was found guilty of being involved in the crime, and sentenced to 20 years in prison (later overturned). In addition, since the IWW opposed America's entry into the First World War, many of its leaders were arrested under the Espionage Act. This tactic of intimidation was highly effective and, by 1925, membership had declined dramatically.

## THE ROOSEVELT YEARS

During the presidency of Franklin D. Roosevelt, elected in 1932 with the support of most trade

unionists, the labor movement scored important victories. Frances Perkins and Robert Wagner, whose sympathy for the trade union movement was well-known, were appointed respectively as secretary of labor and chairman of the National Recovery Administration. In 1933, Wagner introduced a bill to Congress to help protect trade unionists from their employers. With the support of Perkins, Wagner's proposals became the National Labor Relations Act. It created the National Labor Relations Board which administered the regulation of labor relations in industries engaged in or affecting interstate commerce. The act also sanctioned the rights of workers to join trade unions and to bargain collectively with their employers through representatives of their own choosing. Workers were now protected from their employers and, as a result, union membership grew rapidly. While union membership stood at 3.6 million in 1929, in 1938 it exceeded 7 million.

The New Deal era also witnessed the creation of a new confederation of labor. In 1935, John L. Lewis joined with the heads of seven other unions to form the Congress for Industrial Organization (CIO). Lewis became president of this new organization and, over the next few years, attempted to organize workers in the new mass-production industries, including, for the first time, women and African Americans. This strategy was successful and, only two years later, the CIO had more members than the AFL. The two organizations merged in 1955.

In June 1938, Perkins persuaded Congress to pass the Fair Labor Standards Act, whose main objective was to eliminate "labor conditions detrimental to the maintenance of the minimum standards of living necessary for health, efficiency, and well-being of workers." The act established maximum working hours as 44 per week for the first year, 42 for the second, and 40 thereafter. Minimum wages of 25 cents an hour were established for the first year, 30 cents for the second, and 40 cents over a period of the next six years. The Fair Labor Standards Act also prohibited child labor in all industries engaged in producing goods in interstate commerce and limited the labor of boys and girls between 16 and 18 years of age in dangerous occupations.

Another important act passed, thanks to the initiative of Perkins and the vice president, Harry S. Truman, was the Fair Employment Act. This 1942 act compelled all federal agencies to include in their

contracts with private employers a provision obligating such employers not to “discriminate against persons of any race, color, creed, or nationality in matters of employment.” The act set up the Committee on Fair Employment Practice (FEPC), a body that was empowered to investigate all complaints of discrimination.

### TAFT-HARTLEY

However, at the end of the New Deal, the changed political climate prompted the Republican Party and right-wing elements in the Democratic Party to object to the pro-trade union legislation of the Roosevelt administration. On June 23, 1947, Congress passed the Taft-Hartley Act, over the veto of President Truman, who denounced it as a “slave-labor bill.” The act, still in effect, severely limited the power of trade unions.

It forbade jurisdictional strikes and secondary boycotts. It prohibited the closed shop, a workplace where membership of a particular union was a prerequisite for being hired. Other aspects of the legislation included the right of employers to be exempted from bargaining with unions unless they wished to. The act forbade unions from contributing to political campaigns and required union leaders to affirm they were not supporters of the communist party. This aspect of the act was upheld by the Supreme Court in 1950. The Taft-Hartley Act also established the National Labor Relations Board, a body that had the power to determine the issuance or prosecution of a complaint. Under the terms of the act, the U.S. attorney general had the power to obtain an 80-day injunction when a threatened or actual strike was believed to imperil the national health or safety, a proviso that courts have interpreted extremely loosely. During the post-World War II years, the climate of the Cold War also proved damaging for unions and the labor movement. The movement was absorbed by the dominating anti-communism hysteria which pushed unions to disown their class-conscious militancy. In 1949, the CIO expelled 11 unions, amounting to some 900,000 workers suspected of being communist-controlled.

### ORGANIZED CRIME

In the postwar period, many U.S. unions lost much of their prestige when links to organized crime were

discovered. An image of trade unions as source of corruption began to take hold in the public mind. Such a characterization was also dramatized in successful Cold War popular culture products such as Elia Kazan’s film *On the Waterfront* (1954), where rank and file are exploited and impoverished by the mob-infested union, the International Longshoremen’s Association. Some unions progressively acquired the reputation of being groups of thugs who would use even unlawful methods to bring some employers into line.

This was the case, for example, of the Teamsters, the union of truck drivers which was headed from the 1950s through the late 1960s by the famous and controversial labor leader Jimmy Hoffa. Hoffa scored an important success in 1964 when he managed to bring virtually all American truck drivers under a single national master freight agreement. Hoffa’s grand design, however, was to bring all transport employees into the union: this ambition obviously worried American government and business alike which understood how devastating a general strike of all the transportation sector could be for the national economy. Hoffa’s policy brought benefits to truck drivers, yet several local Teamsters leaders agreed to make deals that contributed more to the wealth of union officers rather than to workers’ rights and benefits.

Hoffa also had dangerous ties with the mafia, which, in certain sectors, such as garment delivery, took control of the union and worked to put industries under its control or, at least vulnerable to its blackmail. Some of these mafia racketeers had played an important part in getting Hoffa elected president of the Teamsters. In spite of their many convictions for mob-related crimes, several Teamster chapter presidents often continued serving as union leaders, including Antonio Provenzano, in New Jersey. There is evidence that the Teamsters pension fund was used to fund mob-controlled casinos and hotels.

In the last decades of the 20th century, union membership steadily declined in all sectors except the public one. In the conclusion to her study on the representation of workers in American fiction, Laura Hapke effectively summarizes the predicament of American unions and its leaders who have exchanged “unified labor militancy for a job-security pragmatism” and who “have engaged in their own unfair labor practices by their obliviousness to work-floor and retirement inequities.”

Union members were disappointed but not surprised by their leaders' behavior of permanent mismanagement and greed. Yet, Hapke also denounces "the prevailing cultural amnesia," which affected American public awareness about job protests. Unanimous voices state that the working class and the labor movement are progressively fading out from American consciousness, but such reports may be exaggerated: unions at the beginning of the new millennium are still alive and fighting.

#### SEE ALSO

Teamsters pension fund; capitalism; globalization; labor crimes; Roosevelt, Franklin D.

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## Unisys

IN SEPTEMBER 1991, Unisys, then the fourth-largest defense contractor in the United States, agreed to pay a record \$190 million fine to settle

criminal charges stemming from Operation Ill Wind. Among those implicated in the government investigation of Defense Department corruption were six company executives, several consultants, military officials, and Armand D'Amato, brother of Senator Alfonse D'Amato (R-NY).

Formed in the 1986 merger of Burroughs and Sperry, Unisys became a computer industry giant, second only to IBM in size. Late that year, the company sold its Sperry Aerospace division to Honeywell but overstated assets in the \$1.025 billion deal, leading to a 1993 settlement in which Unisys paid Honeywell \$43.2 million.

Operation Ill Wind was an Federal Bureau of Investigation and Naval Investigative Service project aimed at rooting out fraud in the defense industry. In June 1988, a federal grand jury issued 275 subpoenas; federal agents searched 42 homes and offices in 12 states. Unisys' 1991 guilty plea was the 51st conviction of companies or individuals fingered in the investigation.

Charges against Unisys included bribing Melvyn R. Paisley, an assistant secretary of the navy, and Victor D. Cohen, air force deputy for tactical warfare systems, to gain contracts for the navy's Aegis anti-air warfare system and other military projects. Two years before the Unisys settlement, Garland L. Tomlin Jr., a branch head of the navy's Space and Naval Warfare Systems Command, pled guilty to accepting the largest bribe uncovered in the probe, \$400,000 from Unisys and \$75,000 from Honeywell. Tomlin was sentenced to 18 months in prison.

As well as direct bribery, Unisys was charged with using consultants to make illegal campaign contributions to members of the House Armed Services and Appropriations committee. Unisys also funneled money to D'Amato, hoping that he would lobby his brother. Senator Alfonse D'Amato was reprimanded by the Senate in 1991 for allowing his brother unrestricted access to his office and letterhead; Armand D'Amato was convicted in 1993 of seven counts of mail fraud. The brains behind Unisys' wrongdoing, Vice-President Charles Gardner, pleaded guilty in 1989 to bribing Paisley; on his release, he testified for the government against the younger D'Amato.

The 1991 settlement cleared the way for Unisys to spin off its troubled defense division as Paramax. This company, briefly owned by Loral and then bought by Lockheed Martin in 1996, had its own

woes during multiple rounds of layoffs in the early 1990s. Although still faced with lawsuits from retirees whose health insurance benefits were cut, Unisys is finally showing signs of stability. Among its current products is fraud-prevention software.

#### SEE ALSO

bribery; defense contract fraud; whistleblowers; False Claims Act.

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## United American Bank

THE UNITED American Bank (UAB), based in Knoxville, Tennessee, was part of the Butcher brothers' financial empire which collapsed as a result of numerous legal and banking problems. Jake and C. H. Butcher were originally considered to be some of Knoxville's finest residents. Exercising influence from their financial empire which included 27 banks in Tennessee and Kentucky with over \$3 billion in assets, the Butcher brothers were responsible for funding Knoxville's two tallest buildings and for attracting the World's Fair in 1982.

The brothers worked together well, with Jake taking care of expansions in larger markets and C.

H. dealing with the more rural areas. Jake could win investment from wealthy industrialists while C. H. was persuasive with small community farmers. However, the situation did not remain perfect for long. During the days leading up to the opening of the World's Fair, politicians and citizens began to question Jake's methods of raising money to attract the fair. On the day after the closure of the fair, November 1, 1982, auditors from the Federal Deposit Insurance Corporation (FDIC) set themselves up at UAB headquarters and began conducting a thorough investigation.

#### SURPRISING NEWS

To UAB employees, the length of the FDIC auditors' investigation began to raise concerns. Typical FDIC examinations usually lasted a month or two, but UAB's investigation did not end until February 14, 1983 and on that day, UAB employees were told some surprising news. They were now employees of the FDIC and UAB was served notice of closure by the FDIC for numerous violations.

Depositors had heard of the bank's difficulties and UAB had been paying out large sums of money for weeks leading up to the impending closure. Over the following days, the FDIC shipped in more than \$10 million in currency. UAB's closure sparked a chain of collapse throughout the Butcher brother's empire.

Soon after, another one of the brothers' banks, Southern Industrial Banking Corporation went bankrupt, followed by another 21 affiliated banks in the brothers' financial empire. Consequently, the Butcher brothers and many members of their family were also bankrupt and now under federal and state investigations. Charges were eventually brought against the Butcher brothers, three family members, some friends, and an accountant employed by the family.

Both brothers agreed to plea bargains with the government authorities. Jake, who was guilty of stealing \$17 million in illegal loans and of cheating on his tax returns, ended up with a 20-year prison term and a massive bill for damages. C. H., who was an alleged cocaine abuser, womanizer, and heavy gambler and was guilty of fraud and money-laundering, ended up with 25 years in prison and large fines. C. H.'s wife, Shirley Butcher, also faced three years in prison for assistance with C. H.'s money-laundering schemes.

C. H. served six years of his 25-year sentence before being paroled. Until his death on April 30, 2002, he assisted his second wife with her real estate business. His wife, Shirley, served eight months of her sentence before parole. Jake Butcher was also paroled after serving six years and eight months of his sentence.

#### SEE ALSO

Butcher brothers; bank fraud; accounting fraud.

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## United Fruit

BEFORE 1970, Chiquita Brands International was known as the United Fruit Company, one of the most storied and controversial business in the history of the Americas. The United Fruit Company was established at the beginning of the 20th century, founded through the merger of four banana importing companies.

United Fruit played a key role in the Central Intelligence Agency (CIA)-sponsored removal from power of Guatemala's democratically elected government in 1954. It also assisted in the attempt to overthrow Cuba's communist Fidel Castro regime in 1961. The company became important in trading, especially tropical bananas and pineapples, from the third world plantations to the United States and Europe.

The company, its predecessors and successors included, is an archetypal case of multinational influence extending deeply into the internal politics and policies of so-called "banana republics" and may well provide an example of neo-colonialism. The United Fruit Company owned vast tracts of land in Central America, and sometimes the com-

pany had real power of those nations, with national governments doing the company's bidding.

The company owes its existence to Captain Lorenzo Dow Baker who transported a group of miners to Venezuela from Boston, Massachusetts, in 1870 on his schooner. He put into Port Morant, Jamaica, on his homeward voyage to find a cargo to pay his expenses on the northbound trip. He purchased 160 bunches of unripe bananas there for \$40 which he sold in Jersey City, New Jersey, for \$320. The following year he returned to Jamaica and started steadily shipping bananas to Boston.

In 1884, Baker with J. H. Freeman and A. Preston formed the Boston Fruit Company and acquired their own steamship. Boston Fruit Co. merged with leading banana operators in 1899 to form the world's biggest banana importer, the United Fruit Company of New Jersey with plantations in Colombia, Costa Rica, Cuba, Jamaica, Nicaragua, Panama, and Santo Domingo. Along with rail lines, the company had telegraph lines and plantations all over Central America. United Fruit owned a fleet of white steamships called the Great White Fleet. The company continued to expand into Caribbean and Central American territories and to absorb competing companies.

In 1901, the Guatemalan dictator Manuel Estrada Cabrera ensured United Fruit's exclusive rights to transport postal mail between Guatemala and the United States. Cabrera allowed the company to establish a subsidiary, the Guatemalan Railroad Company, and build a railroad and telegraph lines between Puerto Barrios and the capital, Guatemala City. Furthermore, he gave permission to United Fruit Company to acquire land very reasonably and gave the company a land grant 500 yards wide and one mile long on either side of the municipal pier.

Also, the United Fruit Company was exempted from taxes for 99 years. By 1910, United Fruit Company had won a controlling stake in the British owned Elders & Fyffes Co. and ships were regularly transferred between the two fleets. United Fruit merged with Cuyamel Fruit Company in 1929. In 1970, United Fruit was absorbed into United Brands and subsequently divested itself of its American flagged ships.

The company has a long history of vigilantly political activism. For example, in 1910 a ship of armed hired thugs was sent from New Orleans, Louisiana, to Honduras to install a new president

by force when the incumbent failed to grant the fruit company tax breaks. The newly installed Honduran president granted the company a waiver from paying any taxes for 25 years. By 1918, United Fruit Company and two other companies controlled 75 percent of the nation's banana-growing land, much of it taken through threats or violence.

### THE GUATEMALAN COUP

In Guatemala, in 1944, a group of liberal military leaders seized power and inaugurated a program of land reform under successive presidents, Juan Jose Arevalo and Jacobo Arbenz. They began redistributing United Fruit Company land to citizens. According to some intelligence sources, the Guatemalan government of Guzman was overthrown by covert action by the U.S. government in 1954 at the request of United Fruit because of Guzman's plans to redistribute uncultivated land owned by the United Fruit Company among native peasants. The United Fruit Company and others charged that Guatemala had turned communist and convinced President Dwight Eisenhower to overthrow Guzman's government. As many as 100,000 people may have died in the ensuing war.

In order to administer its distant and dispersed activities, United Fruit became a major developer of radio technology, which it later pooled with other companies to form the Radio Corporation of America. The company had a mixed record of encouraging and discouraging development in the countries in which they had operations. For example, in Guatemala, the company built schools for the people who lived and worked on the company land, while at the same time, for many years, disallowed the Guatemalan government from constructing highways, because this would lessen the profitable transportation monopoly of the railroads, which were owned by United Fruit.

Richard Allen LaBarge (1968) reached a different conclusion from the studies that had prevailed up to that moment. According to his study, United Fruit Company had a positive impact on local economies: As the gross national product per capita increased, the countries got a more developed infrastructure (trains, telegraphs, roads, camps, and plantations).

Thus, the banana-produce industry enabled the developing nations to gain international trade status. LaBarge also argues that the negative criticism

toward the United Fruit Company negates the prevailing business environment in the Central Americas of the era.

The contemporary use of banana labels in the United States dates from the early 1960s when the United Fruit Company began placing its familiar blue Chiquita labels on fruit. In 1970, United Fruit Company merged with AMK Corp. to form United Brands Co., which took the Chiquita Brands International name in 1990. Chiquita's name has been additionally tainted by alleged preferential treatment by the Bill Clinton administration. With its heavy involvement in any Latin American country that was friendly to its policies, United Fruit gave birth to the term "banana republic." Even in 1996, United Fruit/Chiquita evicted 100 Honduran families and grazed their homes after declaring their land "infertile."

The successor of United Fruit has interests in Colombia, Costa Rica, Cuba, Guatemala, Honduras, and Panama. So overwhelming has the impact been on the fabric of history and Central American society that it has inspired poet Pablo Neruda to express this relationship through verse in a poem entitled "United Fruit Company."

### SEE ALSO

Central America; South America; capitalism; free trade.

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## United Kingdom

IN 2002, the Association of British Insurers estimated that fraud alone cost the United Kingdom (UK) economy £14 billion. Estimating the cost of



white-collar and corporate crime is a favorite pastime for researchers and policymakers as well as insurers. Invariably, these educated guesses “prove” that the cost of white-collar and corporate crime is vast, implying that the economic performance of the UK would be dramatically improved if government directed more resources to the plethora of agencies responsible for enforcing economic and social regulations. These attempts to estimate the extent of white-collar and corporate crime reflect increasing public awareness of the problem brought about by a series of high-profile scandals since the late 1970s.

### INVISIBLE CRIMES

Policymakers, law-enforcement officers and social scientists paid little attention to the phenomenon of white-collar crime and corporate crime until the 1970s. These crimes were invisible crimes insofar as many people were unaware that such crimes were being committed, there was little statistical data and what there was related to a handful of offenses. There was very little research into occupational and organizational crime, and responsibility for controlling such crimes was divided among a large number of agencies; controlling white-collar and corporate crime was not on the political agenda and the public was relatively unconcerned. Given the North American origins of the terms *white-collar*, *white-collar crime*, and *corporate crime*, it is not surprising that academic study of white-collar and corporate crime in the UK was slow to develop.

These crimes remained invisible until a series of high-profile cases pushed control of occupational and organizational crime up the political agenda. The scandals of the Lonhro, Guinness takeover of Distillers (1986); Blue Arrow share dealings (1987); Harrods takeover; the Bank of Credit and Commerce International collapse (BCCI, 1991); the posthumous discovery that Robert Maxwell misappropriated funds in the Mirror Newspaper Group pension scheme (1991); Polly Peck (1993); the hostile takeover bid for the Co-op; and the Barings Bank collapse (1995) forged the impression that financial crime was rife in the kingdom.

The sinking of the ferry *Herald of Free Enterprise* at Zeebrugge, Holland (1987), the fire on the *Piper Alpha* oil platform in the North Sea (1988), the Lyme Regis Bay tragedy (1994), and several major train crashes, notably at Potters Bar in 2002,

also drew public attention to industrial health and safety regulations. The contamination of the Camelford water supply with 20 tons of aluminum sulphide in 1988 had the same effect on British public consciousness of environmental protection.

Food crime also became of increasing concern after a series of food scares about salmonella in eggs, *e. coli* outbreaks in Lancashire and Lanarkshire, BSE (Bovine Spongiform Encephalopathy) in cattle and its human variant CJD (Creutzfeldt-Jakob Disease), and GM (genetically modified) food. The 2001 BSE foot-and-mouth outbreak exacerbated worries about food crime after it emerged that infected meat imported illegally into the UK might have caused the outbreak, and that illegal movements of livestock facilitated the spread of disease.

The extensive media coverage of these cases shaped public perception of the incidence of white-collar and corporate crime in the UK. The focus on the most dramatic of cases obscures petty white-collar and corporate crime that occurs more frequently. Despite the best efforts of consumer affairs programs such as the BBC Television's *Watchdog*, securities-trading offenses receive far less attention in the media, although British subjects are far more likely to be the victims of an unscrupulous trader than a major financier. Equally, tax evasion receives very little media coverage.

British criminologists have also played a significant role in the increasing visibility of white-collar and corporate crime. Studies of the policing and prosecution of such crimes have had a significant influence on policymakers and administrators, as well as making a significant contribution to the theory of white-collar and corporate crime. As a result of increased awareness, there are now a plethora of agencies responsible for the prevention, detection, prosecution, and conviction of corporate criminals.

### BRITISH REGULATORS

The Crown Prosecution Service (CPS), the Financial Services Authority (FSA), the Serious Fraud Office (SFO), the Metropolitan Police Fraud Squad, and the Department of Trade and Industry (DTI) share responsibility for policing and prosecuting financial crime. The National Criminal Intelligence Service (NCIS) gets involved in some of the most serious cases of financial crime. The CPS, HM Customs and Excise and HM Inland Revenue deal with the various aspects of tax evasion.

Although many companies lump health, safety and environmental issues together, the responsibility for enforcing regulations governing health and safety in the workplace and the regulations protecting the environment are shared by many agencies. Health and safety crimes fall under the purview of the Health and Safety Executive established in 1974, while the bulk of environmental crimes fall within the remit of the Environment Agency and Local Authority Environmental Health Departments.

Food law is also enforced by a variety of specialist agencies. The Food Standards Agency and its executive agency the Meat Hygiene Service, and the Pesticides Safety Directorate, Veterinary Medicines Directorate and the Dairy Hygiene Inspectorate of the Department of Environment, Food and Rural Affairs tackle food crime at a national level. Their auxiliaries at the local level are the Local Authority Environmental Health Departments, Local Authority Trading Standards Department and Public Analysts.

A whole host of agencies protect consumers from avaricious traders dealing in goods apart from foodstuffs under the watchful eye of consumer groups like the Consumers Association. The DTI, the Office of Fair Trading (OFT) and the Monopolies and Mergers Commission (MMC) deal with antitrust issues. A series of agencies perform a similar function for the privatized utilities, while the OFT and Local Authority Trading Standards Departments deal with trading offenses.

Given limited resources, the size of the task and the consequent need for co-operation from businesses, the specialist enforcement agencies follow a policy of regulatory compliance. Although there are differences of emphasis, these agencies prefer to issue warnings or to impose administrative penalties, rather than prosecute offenders, a process viewed as time-consuming, expensive and unpredictable. Prosecution is reserved for serious offenses and persistent offenders.

Nevertheless, groups representing business interests have lobbied successive governments to reduce the regulatory burden. Both the Conservative governments of Margaret Thatcher and John Major, and the Labor government of Tony Blair have attempted to simplify the administration and enforcement of economic and social regulations. Deregulation was important to the Thatcher and Major governments as reducing state intervention in the economy was central to the Conservative

agenda. Consequently, the Conservative government encouraged "business-friendly enforcement" in the Deregulation and Contracting Out Act, 1994. In 1997, the incoming Labor government emphasized "better regulation" as opposed to "deregulation." However, this change in rhetoric did not reflect a shift in policy. *The Principles of Good Regulation*, published by the Better Regulation Task Force in 1998, and the Enforcement Concordat with Local Authorities and Government departments agreed to shortly thereafter, emphasized the use of persuasive rather than punitive strategies. Government attempts to deregulate business and emphasize persuasive strategies efforts have met with limited success.

## REGULATION REFORM

In 1997, the Labor government reformed financial services regulation merging banking supervision and investment services regulation into the Securities and Investments Board (SIB). The Bank of England, severely criticized in the official report on the BCCI collapse, was stripped of its responsibilities for bank regulation. Within a few months of taking over these duties, the SIB changed its name to the Financial Services Authority (FSA).

A similar process of simplification and strengthening of regulation can be seen in the areas of environmental protection and food law with the creation of the Environment Agency in 1995 and the Food Standards Agency in 2001. The establishment of the Environment Agency simplified the enforcement of environmental regulations, merging HM Inspectors of Pollution with the National Rivers Authority and a handful of smaller agencies. The creation of the Food Standards Agency was, however, more of a public relations exercise than a tidying-up exercise after successive food scares and the foot-and-mouth outbreak in the 1990s. The creation of the Pesticides Safety Directorate and the Meat Hygiene Service of the Ministry of Agriculture, Fisheries and Food (MAFF) in 1993 and 1995 respectively, did not reassure the public who felt that MAFF put the producer interest before the consumer interest. Consequently, the Labor government created the Food Standards Agency.

The origins of the modern food law, environmental law and the law governing trading standards, health and safety at work and financial regulation, as well as the agencies responsible for enforcing

these laws, can be traced back to the 19th century. Nevertheless, discussion of white-collar and corporate crime in contemporary Britain took place in an historical vacuum until recently. Although white-collar crime and corporate crime have been touched upon in historical studies of the development of economic and social regulation, electoral and political corruption, and the informal economy, white-collar crime and corporate crime did not become the subject of historical study in their own right until the 1990s.

#### SEE ALSO

reform and regulation; capitalism; free trade; Bank of Credit and Commerce International; Barings Bank; Maxwell, Robert.

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## United States

**WHITE-COLLAR CRIME** most often involves a network of people in legitimate occupations assisting one another for profit and covering-up wrongdoing. Individually, this often includes lawyers, accountants, stockbrokers, boards of directors, chief executive officers, government regulators, and thrift or banking insiders.

Since 1949 when Edwin H. Sutherland first defined white-collar crime, it has not been a uniquely

American phenomenon. Yet, as the United States has been and remains the pre-eminent capitalist economic power, the nation is also the world leader in corporate criminality, as well as in this relatively new study of criminology.

### THE AMERICAN WAY

Criminal acts by corporations in the United States, rather than resulting in arrest are typically managed by regulatory agencies. They can be referred to the federal Department of Justice if the regulatory agency is unable to get the corporation to comply with the regulation. These regulations are designed to control or manage an offending corporation's behavior. Controlling, managing, and punishing corporate crime has been a difficult challenge in American history. During first major federal attempt, the 1898 Sherman Antitrust Act, passed to prevent monopolies from fixing prices on goods sold to consumers, the Department of Justice only filed 9 cases, and only 16 in the first twelve years. No violators were imprisoned until 1921. During the first 50 years of the law, of 252 prosecutions only 24 perpetrators went to prison. Eleven of these were businessmen and the remainder were union leaders who were being controlled by the laws sponsored by the elite controlled politicians.

Before cases are brought to criminal court, federal and sometimes state regulatory agencies may manage the company through an administrative hearing and a consent decree asking the company to stop its behavior. Subsequently, the company may offer to clean up its mess or perform restitution to victims. Part of the problem in trying to make corporations accountable for the harms that they commit is that a Supreme Court decision in 1886, in *Santa Clara v. California*, declared that a private corporation is a natural person. Thus, they have the same rights as a natural person under the law to freedom of speech, to sue, and to borrow money but unfortunately, finding culpable parties in white-collar crime cases is often quite difficult.

Harm done to workers by corporations in their work environment has been a common white-collar offense in American industry. These offenses ranged from knowingly exposing coal miners to harmful coal dust and lying about it, to improperly locked employee-exit doors. One example of corporate negligence occurred in 1991 at the Imperial Food Products chicken-processing plant fire in

Hamlet, North Carolina, where 25 employees were killed. The employees died because company management had locked the exit doors, allegedly due to suspected employee theft. However, additional problems included the fact the building was over 100 years old and had an inadequate sprinkler system, too few windows, and the plant had not been inspected by the state regulatory agency, the Occupational Safety and Health Administration in its 11 years of operation. In the end, the state hired new inspectors and legislated 12 new workplace safety laws. The state Labor Department fined the company \$800,000 and the owner, plant manager, and his son were indicted on 25 counts of manslaughter. Eventually the owner, Emmett Roe, pleaded guilty to all 25 counts and was sentenced to almost 20 years; but was eligible for parole in less than 3 years.

State-sponsored crime committed by the U.S. government has been problematic for many years. Early, extreme examples include the enslavement of hundreds of thousands of African-American slaves for over 100 and the genocide committed against the Native American tribes. More recent incidents include the Challenger Space Shuttle explosion in 1986, killing all 8 astronauts. Later investigations revealed that engineers and managers knew that at a certain temperature, an O-ring would not function properly but estimated that postponing the launch to repair or replace the faulty ring was not cost-effective and may have endangered NASA's schedule. Therefore, managers and engineers knowingly risked the lives of all the astronauts.

## CONSUMER AND FINANCIAL FRAUD

Consumer fraud or the death of consumers caused by corporate America knowingly producing and selling unsafe products are also a commonly committed white-collar crime. One such case includes Ford Motor Company's 1970 development of the Ford Pinto, an automobile the company knew would explode when rear-ended because of the location of the gas tank, but calculated the cost of lawsuits for wrongful deaths as cheaper than changing the design of the automobile. Similarly in 2001, both Ford Motor Company and Firestone Tires were implicated in a number of automobile accidents involving the Ford Explorer SUV. Eventually, the responsibility was found to lie with the tires constructed by Firestone. Other instances of crimes against consumers include the silicon breast im-

plant developed by Dow Corning and approved by the Food and Drug Administration initially as safe.

Some of the most pervasive instances of white-collar crime included the 1980s financial crimes in the savings and loan (S&L) industry, as well as the insider trading and accounting theft in a number of cases of stock fraud. Insider trading involves the illegal use of important nonpublic information about the sale of stocks or securities, or trading in them, by providing tips to others about forthcoming transactions. In many instances, the stock market has become a market not of products but of information and speculation. Michael Milken committed one of the largest white-collar crimes in history when he created a junk bond market for his company Drexel Burnham Lambert. Milken also provided confidential inside information about deals and then helped clients conceal ownership of huge blocks of stock in anticipation of the deal he already knew was forthcoming. Insider trading is prohibited by a federal regulatory agency, the Securities and Exchange Commission (SEC).

Other prohibitions on stock trading in America include an SEC rule that prohibits individuals from engaging in any act of business that operates as a fraud or deceives any person in connection with the purchase or sale of a securities product. These regulatory laws are aimed at preventing insiders from gaining an unfair advantage in a capitalist market, that is supposed to be neutral where all parties have an equal standing. While this notion of equal standing is true ideologically, in practice it is far from the truth. The landmark Supreme Court decision laying out this rule was the *SEC v. Texas Gulf Sulphur Company*, in which executives in the Texas company purchased large quantities of their own stock before making public their discovery of minerals. Once this information was made public, the stock shot up and the executives made huge profits.

## SAVINGS AND LOANS

Also in the 1980s, frauds committed by savings and loan institutions and the bailout of these institutions by the federal government amounted to what one author referred to as corporate welfare. The regulatory agency responsible for financial institutions like banks and savings and loans companies is the Federal Deposit Insurance Association (FDIC). The federal system of insured savings and loan institutions was enacted in the 1930s in response to

the economic Depression, and to oversee federally chartered savings and loan institutions. The FDIC insures the deposits of federally chartered banks for premiums paid by each bank to the federal government. Basically, the criminal and fraudulent actions of the S&Ls was made possible by federal deregulation of the industry. From 1989 through 1990, over 7,000 cases were referred by the regulatory agency to the Department of Justice. The Federal Bureau of Investigation and sometimes the Secret Service or specialized task forces investigated these suspected crimes. By 1991, 764 defendants were charged, 95 of them were board chairmen, chief executives, or presidents, and 131 were other management personnel. Ninety-three percent of those tried (550) were convicted and 42 were acquitted.

## RULES AND REGULATIONS

In response to the debacles of the mid-1980s, Congress enacted two pieces of legislation in 1984 defining insider trading and securities fraud as a public wrong. The 1984 Insider Trading Sanctions Act of mandates that individuals “found guilty of insider trading violations may face financial penalties of up to three times the profits made (or losses avoided) as a result of the unlawful trading.” Prior to the enactment of this law offenders could only lose their profits. Second, Congress passed the Insider Trading and Securities Fraud Enforcement Act of 1988. This established a bounty program to enhance the detection of insider trading, increased the penalties, broadened the right to private civil action, and imposed a criminal penalty of up to five years, mandated preventative rules for brokerage dealers, investment advisors and firms in order to prevent insider trading.

Under this act, civil remedies can include injunctions or prohibitions of engaging in any more stock trading and can also require changes in the structure and personnel of an offending organization. Moreover, the SEC also can order financial penalties and other administrative remedies. This includes court orders to cease and desist from stock market activities.

For example in 1985, the SEC forced Ivan Boesky to give up \$50 million of his profits gained from his insider trading activities, this money is held in a trust and provided to those individuals harmed by the financial crime. Under these SEC laws and the Supreme Court case of *Dirks v. SEC*

(1986), corporate employees are financially responsible to their shareholders and thus cannot trade that stock without disclosing that they have the nonpublic information. Also, any person who has gained such inside nonpublic information based on a connection to that company and trades on that information is responsible. In this case, culpability can extend beyond individuals directly involved in profiting from trading.

For example, in *U.S. v. Winans* (1985), a newspaper reporter was convicted of securities fraud for publishing insider information provided by an insider who profited from the release of the information in the article. In 1991, even a psychiatrist had charges filed against him for revealing a patient's disclosure of stock information to others. Nancy Reichman analyzed a variety of SEC litigation cases involving insider trading from January 1, 1989, through October 15, 1991, and found that SEC actions included civil complaints, administrative hearings, and criminal sanctions.

For the SEC, catching white-collar criminals is difficult, but punishing them is even more problematic. For example, in 1991, the Federal Sentencing Guidelines became law providing federal judges with a specific set of guidelines to follow in white-collar crime sentencing. While these guidelines mandated the harshest financial penalties ever up to that time, up to \$500 million, this law also provided corporations with an opportunity to police themselves by mandating ethics training and an internal compliance policy structure. But ultimately, these mandates for internal policing encourage companies to scapegoat a particular employee without addressing the corporate culture that encourages increasing profit without taking into account harms against others.

More punitive laws governing corporate crimes were legislated in 2002 as the result of several of the largest corporate bankruptcies in America's history. The story behind the bankruptcies included theft and fraud. Specifically, Enron Corporation, a multinational energy and oil company created a number of executive partnerships to hide the company's financial losses. The SEC began an investigation into Enron and its accounting firm, Arthur Anderson. Subsequently, the accounting firm began destroying paperwork detailing previous audits of Enron's accounting books. It has been alleged that Enron's board of directors were receiving cash payments from illicit partnerships used to hide Enron's debt,

and to make tax-deductible contributions to a variety of philanthropic organizations. During this same time period, Enron executives prevented lower-level employees from cashing in their shares while executives sold their shares at a higher value just prior to filing of the company's bankruptcy. Kenneth Lay, the company's president was selling his own shares while he told non-executive Enron employees to continue to buy Enron shares. Enron executives also bullied analysts who were questioning the value of Enron's stock. Anderson refused to downgrade Enron's credit rating even as bankruptcy loomed. This accounting firm also assisted Waste Management Inc. in developing misleading financial reports. Anderson also performed similar functions for Sunbeam Corporation in 2001 and paid \$110 million to shareholders to settle a fraud lawsuit. Similar bankruptcies and illegal accounting methods were found in dozens of companies.

These crimes resulted public outcry and created pressure on the House, Senate, and the president resulting in the most stringent corporate crime laws to be generated in many years. The passage of the Sarbanes-Oxley Act addressed accounting oversight in order to prevent cheating on the books. The new law also improved criminal fraud accountability with criminal penalty enhancements. The penalty enhancement portion of the bill is referred to as the White Collar Crime Penalty Enhancement Act. It contains five major sections covering attempt and conspiracy to commit criminal fraud; criminal penalties for mail and wire fraud, criminal penalties for violations of the employee retirement income security Act of 1974; Amendment to Sentencing Guidelines Relating to Certain White collar Offenses; and Corporate Responsibility for Financial Reports. Additionally, these new laws also provide the Sentencing Commission with the power to increase the punitiveness of any sentence based upon how much money has been lost to employees or ordinary shareholders.

White-collar crime has characterized the history of the United States since the country's founding. Only in the last 50 years have white-collar offenses been treated and studied as a serious criminology that can financially harm workers and consumers as well as result in serious injury and death.

#### SEE ALSO

antitrust; Sherman Antitrust Act; Clayton Act; Sentencing Guidelines, U.S.; reform and regulation; corporate li-

ability; air pollution; water pollution; unions; Justice, Department of; Securities and Exchange Commission; Food and Drug Administration; Sutherland, Edwin H.

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## unnecessary surgery

FROM THE STANDPOINT of the criminal law, willfully committing unnecessary surgery (or other unnecessary medical treatments) is fraud because it obtains money from the patient under the false pretense that the medical procedure is necessary. It is also a crime against the person because, depending upon the extent of the intrusion, the unnecessary surgery or treatment would involve battery, mayhem, or criminal homicide.

The victim's consent cannot be used as a defense by the offender because consent was obtained under false pretenses. In cases of unnecessary surgeries and treatments by veterinarians, the behavior would comprise fraud and cruelty to animals. Insurance companies who are asked to pay for willfully committed unnecessary surgeries and treatments would also be fraud victims. Concerns about unnec-



*Determining whether a procedure is ineffective or inappropriate is the crux of defining unnecessary surgery.*

ecessary medical procedures in America go back as far as 1775, but standards regulating American physicians' decisions to perform surgeries and treatments were not forthcoming for at least a century and a quarter later.

It was not until the first decade of the 20th century that Ernest Amory Codman proposed to assess the competency of hospitals and physicians through his "end-result plan," which tracked hospital patients after medical procedures. Codman was appointed as chairperson of the Clinical Congress of Surgeons' (the forerunner to the American College of Surgeons) Committee on Hospital Standardization, a role in which he crusaded for a national standardization in hospital medical care. In 1920, John G. Bowman, the first director of the American College of Surgeons, advocated "minimum standardization" to identify unnecessary surgery and lax diagnoses.

Defining exactly what is "unnecessary" surgery or treatment is problematic. Whether a medical procedure is ineffective or inappropriate for a given

medical circumstance is the crux of what is meant by unnecessary. Yet, any operation or treatment that fails to produce its desired result can later be judged as ineffective and inappropriate, though there initially was a presumed potential to help the patient.

Perhaps the best way to define a criminal unnecessary medical procedure is when a doctor knowingly lies by telling a patient that her condition requires a particular surgery or treatment. This approach includes nearly all connotations of intentional fraud in the delivery of medical procedures by legally practicing physicians. It would include the delivery of procedures known by the physician to be ineffective. It would also encompass delivering procedures without advising the patient about other methods known to the physician that would have the same outcome and be less expensive or less intrusive.

Unintentional unnecessary medical procedures should not be confused with the intentional ones; the former are civil wrongs (torts) and result from incompetence while the latter are crimes that result from intents to defraud. Of the many billions of dollars paid each year for unnecessary physician procedures, a portion is spent because of incompetence and the rest is the product of doctors' willful attempts to defraud and to maim. Incompetent decisions to perform unnecessary surgery may be so plainly bad that they meet a prosecutor's legal threshold for charges of criminal negligence.

The primary type of research documenting unnecessary surgery involves a geographic comparison of surgical rates. Huge differences in surgical rates for certain geographic areas have been found especially for tonsillectomies, hemorrhoidectomies, hysterectomies, heart surgeries, and hernia operations. Researchers have also documented higher surgery rates among physicians who charge a fee for each service compared to HMO physicians who do not. "Second opinion" studies have shown that as many as a fifth of prescribed surgeries are not validated by peers. And expert specialists have often been found to disagree with their colleagues' diagnoses.

These four methods of studying unnecessary surgery have presented information of varying strength to support the idea that many operations need not happen, but none of them allow us to infer the extent of doctors' criminal intent to perform unneeded operations. However, when gross

discrepancies—such as a tenfold higher rate of a surgery type in one area compared to another—are present, it is difficult to explain away the difference without acknowledging that at least some would have been known to have been unnecessary before they were performed.

There have been several reasons put forth that try to explain wrong decisions to deliver unnecessary medical treatment, including training (doctors practice the way they were taught in medical school); insufficient knowledge to make competent diagnoses (doctors often do not pay attention to all of the relevant symptoms or keep abreast of medical developments); individual physician characteristics (age, experience, personality, and medical specialty); and the practice of “defensive medicine” (doctors over-prescribe medical procedures as a defense against possible future medical malpractice lawsuits). None of these ideas purporting to explain unnecessary treatments and surgeries involve intentional fraud by the doctor.

It would be difficult to argue for the differential association theory that says physicians learn from their peers and mentors specific attitudes favorable to the delivery of unnecessary surgeries and treatments, given the strong normative system in medicine that emphasizes the best interests of the patient. Self-control theory would probably be most relevant as an explanation, because criminal unnecessary surgery is not only an example of “easy money,” but also reflects an extreme insensitivity to the feelings and rights of others.

To demonstrate self-control theory as a correct explanation, research would have to indicate that physicians who willfully lie to patients about the necessity of their surgery or treatment are also more likely than their colleagues to be involved in other medical crimes (such as prescription violations, insurance fraud, patient sexual assault). Those who fraudulently deliver unnecessary treatments and surgeries should also be more likely than those who do not to be involved in non-medical criminal behaviors such as tax evasion, and various risky and deviant noncriminal behaviors, such as gambling, alcohol abuse, and sexual abuse.

The self-regulating nature of the medical community accords great deference to the validity of individual physician opinion. This circumstance will continue to insulate those who willfully defraud and maim patients, because there will be little perceived probability of being exposed as a criminal by

one’s fellow doctors. Reaching any reliable figure of criminal unnecessary surgery is extremely problematic because the included acts must involve either criminal intent or criminal negligence, both of which may only be determinable after legal conviction.

#### SEE ALSO

healthcare fraud; insurance fraud; Medicare and Medicaid; differential association; self-control theory.

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## Unsafe at Any Speed

IN 1965, Ralph Nader, a 31-year-old attorney, published *Unsafe at Any Speed: The Designed-in Dangers of the American Automobile* (Grossman), excoriating the Detroit, Michigan, automotive industry for its privileging of style and design over consumer safety. Nader’s book eventually became a bestseller and, many believe, helped pass what became the country’s first automobile safety legislation.

Nader had been interested in issues of consumer safety since he was a law school student at Harvard University and the editor of the *Harvard Law Record*. While editor, he published an article entitled, “American Cars: Designed for Death,” the first of several articles Nader wrote on this subject. He subsequently published articles in *The Nation* and in *Personal Injury Annual*, calling attention to Detroit’s deliberate choice of making style a priority over safety.

The rising death toll from traffic accidents was also driving Congressional and governmental leaders to look at the issue of automobile safety. For years, driver error had been the sole focus in investigations of traffic accidents. Nader and others suggested, however, that the cars themselves might be



to blame in many cases. Nader's interest in this cause attracted the attention of Daniel Patrick Moynihan, then assistant secretary of labor, who hired Nader as staff consultant for highway safety. Nader's assignment was to research and write a report on this issue for a Congressional audience.

*Unsafe at Any Speed* was the result of this assignment. In his book, Nader attacked the entire Detroit auto industry, but General Motors (GM) and its Chevrolet Corvair came under particular fire. The Corvair had been a controversial issue in the courts since 1961 when a woman lost an arm after her Corvair flipped over and subsequently sued GM for selling cars with unsafe steering designs. The case was settled out of court before a decision was reached, but other cases followed. In fact, by 1967 around 150 lawsuits had been filed against GM and its Corvair. Many of these were also settled out of court, but GM won several judgments in cases that actually went to trial. Nader also noted problems with other automobiles such as the Buick Roadmaster and the Ford Mustang. He described features such as steering wheels whose design could easily impale a driver in a crash, poor exhaust systems, and the unnecessary pollution produced by badly engineered cars.

Ironically, the driving public that Nader hoped to outrage with his detailed assault on Detroit virtually ignored the publication of the book until GM took a hand. Apparently worried about Nader's influence in Washington, D.C., and afraid the public might take notice of his book, GM hired private investigators to look into Nader's financial and private life in hopes of smearing his reputation, which to date had been spotless. Nader discovered the investigation and publicly denounced GM's tactics, alleging that the "investigators" had even hired several young women to lure him into a sexual liaison. Nader quickly sued GM for harassment. GM settled the court case for \$425,000.

The first safety legislation was passed in 1966 with the National Traffic and Motor Vehicle Safety Act and the Highway Safety Act. A range of safety

standards for automobiles followed, including padded steering wheels, shoulder belts, safety glass, rear "back-up" lights, emergency flashers, and other design features. The 1966 laws also established an agency to regulate the automobile industry and protect consumers. This agency eventually became the National Highway Traffic Safety Administration.

Nader went on to become the most recognizable and influential champion of the consumer advocacy movement. In 1968, he founded the Center for the Study of Responsive Law with money from the GM settlement. The Center's staff quickly became known as Nader's Raiders as they focused their investigations on issues relating to consumer safety and health. Nader also founded other consumer rights groups, including the Public Interest Research Group, the Center for Auto Safety, the Clean Water Action Project, and many others.

Although the influence of these consumer advocacy groups has waned somewhat since the 1980s, no one denies the impact Nader and his book *Unsafe at Any Speed* had in establishing standards for consumer safety. The title of his book has been used repeatedly to describe products from baby carriages to cell phones whose design somehow imperils the safety of its user.

#### SEE ALSO

Corvair; General Motors; Nader, Ralph; National Highway Traffic Safety Administration.

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# V

## Vatican Bank

THE VATICAN Bank scandal is one of those affairs which will not fade away and still haunts the media, because the secrecy of the authorities (in this case, especially of the independent Vatican state) provides the breeding ground for conspiracy theories of all kinds. As time goes by, fact, semi-fact, fiction, and pure nonsense become inextricable. In the beginning of the Vatican Bank scandal some major factors linked together: unprofessional management by Catholic clergy not trained for the high-risk banking business, a profit orientation of a Catholic institution not bound by the high moral standards proclaimed by the Catholic church, criminal elements within and outside the bank, and last, but not least, the chaotic Italian political system since World War II.

To get to the indisputable core of the scandal, one has to focus on Roberto Calvi, president of the Banco Ambrosiano, and on Archbishop Paul Marcinkus, head of the Istituto per le Opere di Religione (sometimes referred as Istituto per le Opere Religiose; the Vatican bank). The third person was a certain Italian financier and banker, Michele Sindona, who had strong Italian Mafia links.

These three persons interacted financially on a large scale, the details of those operations still remain a mystery. Disaster happened when high-risk

currency deals by Calvi failed in the early 1980s and the Italian National Bank had to intervene. On June 18, 1982, Calvi was found hanging from the Blackfriars Bridge in London, England; Archbishop Marcinkus went into exile within the borders of Vatican City (or state), which was extraterritorial for the Italian police and judiciary. The financial collapse and the loss of money for the Vatican (and others) was gigantic and involved not only institutions in the Vatican state and Italy, but worldwide (especially in distant tax safe-havens in exotic places). Although judicial investigations in several countries and parliamentary inquiries in Italy tried to get a clear picture, the special status of the Vatican as a sovereign entity hindered a proper and thorough clearing-up of the mess.

The conspiracy theories came in, which cannot be dismissed out of hand: The most influential book on this subject was published by the journalist David A. Yallop in 1984. Yallop linked the Vatican Bank scandal directly to the sudden death of Pope John Paul I after only 33 days in office in 1978.

He claimed that John Paul I was murdered, because this new Pope was on the way to get rid of Marcinkus as head of the financial operations of the Vatican, and because he would have discovered the improper deals with elements of the Mafia via Calvi and Sindona, which were at least tolerated by Marcinkus. The background for Yallop's highly

speculative story is the political situation in Italy since the late 1940s: Faced with a large Italian Communist Party, the United States, during the Cold War period, fostered all sorts of anti-communist groups, including former personalities of the fascist Benito Mussolini rule (such as Prince Junio Borghese).

The Italian democracy was riddled for decades not only by Mafia crimes, but also by attempted coups from the military and intelligence community, and by terrorism of the extreme left and the extreme right. The main player of the rightwing anti-democracy plot(s) in the 1970s was Licio Gelli and his secret organization Propaganda 2, which was outlawed when it was discovered by chance by the authorities. A main part of the argument of Yallop is the link between Italian politics, Gelli, Sindona, Calvi and the Vatican, which led by his speculation to the murder of a Pope.

Other authors near the Vatican situation, like John Cornwell in his 1988 book *A Thief in the Night*, disputed Yallop's Pope thesis. But even at the publication of Yallop's book in 1984, the Vatican Bank scandal was overshadowed, in real life and in conspiracy theory circles, by the attempt to kill Pope John Paul II on May 13, 1981. Although the marksman, Ali Mehmet Agca, was arrested on the spot and later convicted, his motivations and possible handlers remain a mystery. The murder case became part of the last period of the Cold War propaganda battles, when the late Claire Sterling published *The Time of Assassins* in 1983. This pamphlet accusing Eastern intelligence organizations from Bulgaria and the Soviet Union of the attempted murder of the Pope of Polish origin is by now generally dismissed as at least unofficial Western disinformation.

Nevertheless this unrelated case and many "minor" incidents (like unsolved kidnapping cases within the Vatican community or a murder/suicide involving three persons within the Swiss Guards corps of the Vatican in 1998) add to the perpetuation of the Vatican Bank scandal mystery. In July 2003, the Italian authorities officially blamed the Mafia for the death of Calvi. The only certainty in these cases is the demonstrated will of the Vatican not to lift the veil of secrecy.

#### SEE ALSO

Banco Ambrosiano; Italy; organized crime; extortion; bribery.

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## Vaughan, Diane (1951–)

DIANE VAUGHAN IS BEST known for her extensive work on the organizational deviance and the development of a general theory of the normalization of deviance. Much of her research explores mistakes and misdeeds that have resulted in disaster—the dark side of organizations. Her seminal work on the space shuttle disaster, *The Challenger Launch Decision: Risky Technology, Culture, and Deviance at NASA*, was published in 1996. Vaughan, along with millions of Americans, watched as the space shuttle exploded on national television. The tragedy prompted her search for an explanation of why the National Aeronautic and Space Administration (NASA) had failed to prevent the tragedy.

Vaughan's nine-year research endeavor found that common speculations that NASA had ignored potential risks were superficial at best. Based on over 200,000 pages of interviews and internal NASA documents housed at the National Archive, Vaughan discovered officials and managers at the space organization had not violated agency policy and procedures in their decision to launch the Challenger. In fact, the strict adherence to rules and protocol took precedence over indications that forecasted any potential for disaster. "The decision to launch Challenger was, incredibly and sadly, a mistake embedded in the banality of organizational life," according to Vaughan.

"No fundamental decision was made at NASA to do evil; rather, a series of seemingly harmless decisions were made that incrementally moved the space agency toward a catastrophic outcome." The book has received numerous accolades, including the Rachel Carson Prize, Alpha Sigma Nu National Book Award, Robert K. Merton Book Award, along with nominations for a Pulitzer Prize and Na-

tional Book Award. Vaughan received her Ph.D. in 1979 from the department of sociology at Ohio State University. She first established her career as a post-doctoral fellow in the sociology of social control at Yale University and then as a research associate at Wellesley College Center for Research on Women from 1982 until 1984. She began teaching at Boston College in 1984 and was 20 years later a professor in the department of sociology. Vaughan received the Donald R. Cressey Memorial Award in 1995 and was a visiting fellow at the American Bar Foundation in Chicago and the Centre for Socio-Legal Studies, Wolfson College at the University of Oxford, England.

Vaughan's areas of specialty in research include organizational theory, cultural sociology, qualitative methods, and science, knowledge, and technology. Her contributions to the field of white-collar crime are numerous, including victimology studies; organization, motivation and control of fraud; and social deviance. Vaughan's book, *Controlling Unlawful Organizational Behavior*, was published in 1983. *Uncoupling* is a highly acclaimed book on intimate relationships that examines breakups from sociological and psychological perspectives.

#### SEE ALSO

Morton Thiokol; *Challenger* Disaster; negligence.

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## Vietnam War

IN THE VIETNAM WAR of the 1960s and early 1970s, both the Americans and the North Vietnamese were the protagonists of brutal war crimes, though the more advanced American arsenal took by far the greatest toll. The main aerial strategy adopted by the Americans to win the war, which

Congress never officially declared, was an infringement of the Fourth Geneva Convention of 1949. From the very start of the conflict, the American aerial campaigns took the form of the so-called carpet or area bombing, a practice which contravenes all the norms about civilian protection in the 1949 convention. Particularly infamous examples were the Christmas bombing of 1972 against Hanoi and Haiphong, cities in North Vietnam.

These area bombers were incapable of precision and they had never been employed in attacks against cities before. In addition to indiscriminate bombings, the American government was responsible for the practice of declaring whole villages and populated areas as "free fire zones," thus destroying them altogether and killing their residents. In the eyes of military officers, this practice was justified by the conviction that many South Vietnamese villages provided a safe shelter for Vietcong.

In fact, investigations carried out after the destruction had already taken place revealed that many of these zones had been peaceful and should not have been targeted. In the confusion of the Vietnam War, it was virtually impossible for the American troops to establish with certainty whether a village was siding with the North or the South Vietnamese. The most gruesome example of these military assaults was the My Lai Massacre in 1968, when the military unit led by Lieutenant William Calley entered the hamlet of My Lai and for hours savagely destroyed it and killed its inhabitants. Although Calley was court-martialed in 1971, President Richard Nixon ordered him released from jail.

The American military-industrial complex (first warned of by President Dwight Eisenhower) was fundamental to the atrocities of the Vietnam War. Dow Chemical, for example, became a notorious symbol of the brutality and ruthlessness of the American military assaults. The company perfected napalm, the jellied gasoline first developed by American chemists during World War II, at its laboratory in Midland, Michigan, and became the sole supplier of this destructive chemical during the war. Napalm inflicts particularly horrible injuries, burning its victims and melting their skin so that the substance remains in their bodies leading to a slow death.

Huge quantities were dropped over Vietnam on suspected enemy targets such as villages or hamlets rumored to be sympathetic to the North's cause.

The savagery of this weapon was captured in the famous photograph of a young, naked Vietnamese girl screaming in pain as she fled a U.S. air strike which dropped napalm on her village. (The girl has since become a physician.) Dow's role in the manufacture of napalm brought it worldwide notoriety, and made it a target of the antiwar movement.

Dow's other contribution to the Vietnam War arsenal, Agent Orange, is famous as much for its effects on American soldiers as for the toll of death and suffering among the Vietnamese. Agent Orange was a defoliant sprayed from 1965 to 1975 over millions of acres of Vietnamese jungle to deny cover to the North's infiltration. These were called "area denial missions" (ADM) and resulted in the complete destruction of the vegetation of entire areas of the country. Agent Orange is made of dioxin, one of the most toxic substances ever devised by American industry. This lethal weapon was sadly effective on people, too. Tens of the thousands of American soldiers and airmen who were exposed to Agent Orange were subsequently diagnosed with diseases resulting from chemical poisoning such as cancers, brain and nerve damage, and damage to reproductive organs. From 1975 onward, it became apparent that an unusual number of Vietnam veterans were affected with non-Hodgkins lymphoma and skin sarcoma. Vietnamese citizens were obviously exposed to the chemical in vast numbers and experienced similar consequences in terms of disease, death and birth defects, but there has never been an official and comprehensive study of the Vietnamese victims of Agent Orange.

Vietnamese doctors, however, have reported significant increases in birth defects among the communities located in the affected areas. In the same way, there has never been an official survey of the environmental impact of Agent Orange, but huge regions of Vietnam are described as looking like a moonscape and are deemed unsuitable for agricultural use. The testimony of George Claxton, a Vietnam veteran, exposed the wide use of Agent Orange in the U.S. military campaign and the scarce information among soldiers on its deadly effects: "I took showers in the stuff. We had wooden stalls

with a tub overhead filled with rainwater that was tinged slightly orange. We would pull the string hanging in the shower and bathe in it. We knew it was Agent Orange because we saw the planes spraying it on the jungle every day. We didn't think anything of it really and at first we thought, the army is spraying for mosquitoes."

Public opinion worldwide began to denounce the American behavior in southeast Asia. As a result of these protests, the Pentagon tried to limit the atrocities, issuing, for example, stricter rules to declare a free fire zone. Yet, legal scholars and historians agree that these rules were completely ineffective. This failure to contain the propensity of the troops to commit war crimes resulted in the international conviction that American soldiers were undisciplined, and even Vietnamese who were not sympathetic to the communist cause started to feel that Americans did not value Vietnamese lives.

Finally, a cease-fire agreement was signed in January 1973 in which the Americans consented to withdraw all their troops within 60 days and to the formation of a coalition government in South Vietnam which would also include the communists. The violations to the agreement by both North and South led to continued conflict between the two countries which ended in 1975 with the collapse of the South Vietnamese government and the unification of the whole country under a communist regime.

#### SEE ALSO

war crimes; military-industrial complex.

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# W-Z

## wage crimes

WAGE CRIMES ARE violations of laws, treaties, or international conventions (hereafter simply, laws) that govern wage rates, work hours, and other aspects of employment for specific categories of workers. The concept is sometimes used more generally to cover any abusive practices related to wages or working hours. Wage laws are based on the idea that there is an inequality of bargaining power between workers and employers, with employers holding a stronger position than workers.

As a result, wages might be “too low,” while other working conditions, such as working hours, might also be worse than they should be. Such inequality of bargaining power is most pronounced when workers are less skilled and less informed about their options in the labor market. Because highly skilled workers are usually paid far more than the legally mandated wage rates, wage laws usually come into play only for the benefit of those workers least able to defend their own interests.

The standards by which wages are judged to be too low or working conditions too bad vary depending on the context, and are not always well-defined. Often, such judgments can be moralistic. Sometimes, they are based on economic, legal, or social theories. From the viewpoint of mainstream (neoclassical) economic theory, each worker’s wage

is determined by the marginal product of labor for a worker in that category. This is equal to the extra revenue that a company would receive from one additional unit of labor by a worker of that type. As a result, many mainstream economists often dismiss wage laws as either superfluous or harmful. How-



*A wage earner's pay slip, usually attached to the check, should explain all income and deductions for a pay period.*

ever, the mainstream theory of wage determination has definite flaws. It is based on a model of competitive labor markets that never exists in the real world, and assumes that employers can determine worker productivity with a precision that is impossible except in very simple situations which are not the norm.

From the viewpoint of some worker advocates, including some economists, wages are determined not by the marginal product of labor but by the relative bargaining power of businesses and workers. Because the individual worker's livelihood depends on securing employment, while a business can almost always be profitable without a particular worker, the worker is in an inherently weaker bargaining position than the employer. As a result, wages are set below the marginal productivity of labor, whatever it is, while any surplus is reaped by the employer as additional profit. This view also has its problems, but it has the merit of being closer to reality than the neoclassical theory.

## LEGAL FRAMEWORK

In the United States before the 1930s, wage laws were rarely enacted and were almost always struck down by the courts. During the Great Depression of the 1930s, however, massive unemployment led the federal government and courts to take a more supportive view of wage laws. In 1931, the U.S. Congress passed the Davis-Bacon Act, which required that government contracts include a clause specifying the minimum wages to be paid to workers in various categories. Wages were to be "no less than the locally prevailing wages and fringe benefits paid on projects of a similar character." Though it applied only to workers employed under government contracts, Davis-Bacon was the first U.S. federal wage law.

In 1938, the U.S. Congress passed the Fair Labor Standards Act (FLSA), which was amended in 1949 and in later years. This law established a national minimum wage for most private employers, as well as rules governing working hours, overtime pay, and the employment of minors. Certain categories of employees, such as managers, are not covered by the law. In theory, only companies with at least two employees and whose business affects interstate commerce fall under the FLSA. However, the government construes almost all private business activities to affect interstate commerce, so very

few firms are exempt from the minimum wage and other FLSA requirements. The FLSA is enforced by the Wage and Hour Division of the U.S. Department of Labor. Violations of the law can be punished by civil actions, injunctions, or criminal prosecution, though the latter is seldom pursued.

In 1963, the U.S. Congress passed the Equal Pay Act, which forbids wage discrimination based on sex. Employers must pay the same wages to both sexes for work that requires similar skill, effort, and responsibility under the same working conditions. The Equal Pay Act launched a new view of what wage levels should be, apart from the marginal-product and bargaining theories: the so-called comparable worth theory, which asserted that jobs requiring the same skills and working conditions were of comparable worth. This was the job-market counterpart of the labor theory of value in goods markets. Just as the labor theory of value held that the value of goods was determined not by market forces but by the amount of labor required to produce them, comparable-worth theory held that the value of work was determined not by market forces but by the skill required to perform it.

In 1964, Congress passed the Civil Rights Act, Title VII of which went beyond the Equal Pay Act to forbid wage discrimination based on race, religion, sex, or national origin. This, too, had far-reaching implications. Internationally, wage and hour laws vary widely. In developing countries, they are almost non-existent. In European countries, they are more demanding than U.S. laws. France, for example, enacted in 2001 a law mandating a 35-hour work week. Predictions of economic disaster based on mainstream economic theory have not come true, and French workers' productivity has actually increased. Thus, the effects of wage and hour laws are still a matter of dispute.

## NOTABLE CASES

Notable wage-crime cases would fill several volumes. A few of the most influential cases are:

*Lochner v. New York* (198 U.S. 45, 1905). Lochner, owner of a bakery, was convicted of violating a New York state law that prohibited requiring bakers to work more than 10 hours per day or more than 60 hours per week. The U.S. Supreme Court found in favor of Lochner and struck down the New York law, stating that it violated the Due Process Clause and the 14th Amendment.

*Corning Glass Works v. Brennan* (417 U.S. 188, 1974). Corning Glass Works paid its night-shift inspectors, all of whom were male, a higher wage than its day-shift inspectors, all of whom were female. The U.S. Department of Labor sued Corning under the Equal Pay Act. The Supreme Court ruled against Corning, and held that the time of day when work was done did make jobs different under the comparable-worth doctrine.

*Dalheim v. KDFW-TV* (918 F.2d 1220, 5th Circuit, 1990). A group of editors, reporters, producers, and directors of the station's local-news show sued the station, arguing that they were wrongfully denied overtime pay required by the FLSA; the station argued that they were not covered by the FLSA because they were professionals. The court held that based on the nature of the work the employees did, they were indeed covered.

#### SEE ALSO

labor crimes; gender discrimination; racial discrimination; globalization.

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## war crimes

THE MAJORITY OF the literature on white-collar and corporate crime generally focuses on financial and commercial crimes. Yet, the historical conditions in the last decades of the 20th century and the beginning of the 21st, such as the bloody, ethnic wars in the Balkans, Africa, and the Middle East as well as state-organized terrorism, have prompted a

growing interest in the area of state and governmental crimes.

Although numberless treaties, protocols and conventions regulate the laws of war, images of concentration camps, ethnic cleansing, torture and execution of prisoners and civilians, rape, bombing of cities and of their monumental patrimony are still a very vivid part of our collective memory. All these actions can be defined as war crimes, as violations of the laws of war, or International Humanitarian Law (IHL). While our familiarity with war crimes has been dramatically enhanced and disseminated by media coverage of more recent wars, legal limitations on the behaviors of soldiers and armies were first contemplated by the Greeks and by the Hindu code of Manu (200 B.C.E.).

The early theories of war were elaborated by philosophers as a reaction to the religious wars that devastated Europe in the 16th and 17th centuries. Equally, while tribunals and reconciliation committees for war and military crimes have been widely invoked after the Second World War, the first trial for war crimes dates back to the 15th century when Peter von Hagenbach was sentenced to death for wartime atrocities.

As a result of the atrocities suffered by prisoners and expeditionary forces during 19th century conflicts such as the Crimean War and other struggles for national independence; calls for drafts that would codify the rules of military engagement began to multiply. During the American Civil War, President Abraham Lincoln appointed to this task the New York professor, Francis Lieber, whose Lieber Code had a deep impact on all subsequent conventions and protocols. These were mainly held and signed in two European cities: The Hague, Holland (in 1899, 1907 and 1954) and Geneva, Switzerland (in 1925, 1929, 1949, and 1977). These conferences, while remaining silent on the legitimacy of war itself, addressed problems raised by the conflicts that had taken place just before their assemblies.

Atrocities included the use of poisonous gases and biological weapons, the fate of the wounded and sick on land and at sea and of prisoners of war, the destiny of civilian noncombatants, and the protection of cultural monuments. In addition to the rules codified during these events, the Nuremberg tribunals of Nazi leaders (1945–49) theorized the concept of crime against humanity, which was reinforced by the 1948 United Nations Convention on



the Prevention and Punishment of the Crime of Genocide.

The 1945 Charter of the international military tribunal at Nuremberg classified war crimes as "violations of the laws or customs of war," and included under this rubric murder, ill-treatment, or deportation of civilians in occupied territory; murder or ill-treatment of prisoners of war; killing of hostages; looting of public or private property; willful destruction of municipalities and gratuitous devastation.

All the conventions and the protocols of the 20th century testify to the commitment of several generations of diplomats and legal advisers. Yet, while the principles behind this impressive monument to international humanitarian law are difficult to question, its effectiveness has been routinely challenged. What all the agreements and codes have left unanswered, at least until the establishment of the tribunals for the wars in the former Yugoslavia and in Rwanda, is key to their existence: how to enforce their norms and, subsequently, how to prosecute effectively the individuals or the states found guilty of war crimes. Although prosecutions have been carried out following the fall of cruel military dictatorships such as the ones in Greece, Chile, Argentina and several governments have been found guilty of breaching human rights norms, the bulk of international humanitarian law has remained in a state of severe paralysis throughout last century.

Another problematic aspect of the legislation concerning war crimes is that civil wars are almost completely ignored it since many states consider the conduct of internal wars as part of their jurisdiction. In many cases, it is difficult to determine the point at which a violent confrontation within a single state goes beyond the sphere of domestic jurisdiction and becomes a case for international law. States are usually unwilling to admit that the situation has progressed out of their control, while dissidents usually appeal to the international community claiming theirs is a cause for international concern.

This is the case, for example, of the conflict in Chechnya: while Russians define it as simply an anti-terrorist police action, international observers have argued that it is an internal armed conflict as defined in international law. In 1977, the second Additional Protocol to the Geneva Convention provided basic rules for the conduct of internal conflicts but did not contain any provisions on the

criminal liability for their breaches. Therefore, the tribunals which were set up among general skepticism for the crimes in the former Yugoslavia and Rwanda had to refer directly only to Article 3 of the Geneva Convention (the only article in the Convention that does refer to civil war) and the added protocols, so that the list of grave breaches to be considered war crimes turned out to be considerably shorter than that applicable to interstate conflicts.

The case of civil wars points to the weakest part of International Humanitarian Law. For all its conventions and protocols, the legislation regarding war crimes is difficult to enforce and its mere existence does not guarantee that criminals will be arrested and prosecuted. The implementation of the laws regarding war crimes are left to the good will of the single states, although, given the shocking reports of the wars of the 1990s, the United Nations as well as other international organization are increasingly advocating this role for themselves. The Geneva Convention states that governments have the duty to search for all persons suspected of committing war crimes. Once caught, they should either be extradited or tried. All states have the legal right to prosecute war criminals thanks to the principle of universal jurisdiction. Yet, this all-embracing universalism clashes with the scarcity of prosecutions. In spite of the obligations to prosecute, governments have often granted impunity or simple administrative punishment to war criminals. The few court cases have become historical events such as the American trial related to the My Lai incident in March 1968, in which American soldiers had shot several hundred unresisting Vietnamese non-combatants in Quang Ngai Province.

In this climate, the tribunals for the crimes in Rwanda and Yugoslavia came as surprises. Yet, the five permanent members of the Security Council delayed the appointment of a permanent prosecutor for more than a year and forced several administrative and financial restrictions, endangering the activity of the tribunals. The UN has always showed an ambiguous relationship to the regulations of the Geneva Convention and states have often used their participation in UN actions to escape legal obligations regarding war crimes. This may happen because the forces entrusted with peacekeeping duties answer uniquely to the Security Council and the UN is not a party to the conventions. In this way, the UN can display its troops

without remembering to issue statements reminding states of the relevant applicable rules of the Geneva Convention and of the duty to punish violations. Examples of this failure to remind states of their obligations under the Geneva Convention include the operations in Kuwait, Bosnia, and Cambodia.

One of the sanctions following the liberation of Kuwait in 1991 even violated the rule of the Geneva Convention that grants free passage of humanitarian aid intended for civilians. Critics of the UN position toward war crimes argue that without the control of an international legal regime, the ones effectively in charge of accomplishing the UN's often ill-defined directives (ranging from passive peace-keeping to active peace-enforcing) are the military on the battlefields. Obviously, with a Security Council far away and incapable of carrying out their monitoring tasks, commanders always keep the priorities of their own governments clear in mind and interpret their mandate accordingly. War crimes often get quickly dismissed. Particularly infamous cases include the 1992 UN personnel's visit to Sonja's Kon-Tiki, a pension outside Sarajevo, Yugoslavia, which the Bosnian government had denounced as a cover-up for a Serbian concentration camp, and the shooting of a Somali intruder in cold blood in 1993 by Canadian troops. During the same year, hundreds of Somalis were also detained and denied the assistance of the Red Cross.

The implementation of the laws of armed conflict and the prosecution of perpetrators of war crimes relies entirely on the will of the political leaders of the main world powers. Yet, their record on the matter is far from being flawless and their interests often control international organizations and entities that should account for war crimes. For example, following the Yugoslavian example, North Atlantic Treaty Organization (NATO) forces were charged of war crimes for its 1999 bombing campaign. Carla Del Ponte, chief prosecutor at the former Yugoslavia tribunal rejected the option of opening an inquiry into NATO's role, saying that there had been no targeting of civilians or other illegal activity by NATO during the 78-day assault. One should perhaps bear in mind that the tribunal's former presiding judge referred to Madeline Albright, then US. secretary of state, as the court's "mother."

An independent and unofficial European tribunal, held in Berlin, Germany, in 2001, came to a

very different conclusion. It cited NATO officials and provided as examples of war crimes the strategy of targeting civilians to pressure them to rise against their own government, the destruction of the Belgrade Radio Television Serbia Studios, which killed 16 journalists, as well as the use of cluster bombs and depleted uranium, whose harmful effects are still visible.

Though these unofficial tribunals have no real legal power, their verdicts should alert public opinion of the lack of any existing body for unprejudiced institutional recourse and the risk that war criminals will not be prosecuted thanks to the vetoes of world powers. In this bleak overview, a hopeful note is provided by the enforcement in 2002 of the Statute of the International Criminal Court at the Hague.

#### SEE ALSO

Vietnam War; American Civil War; American Revolution; prisoners.

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## Waste Management, Inc.

WASTE MANAGEMENT, Inc. (WMI) is one of the largest refuse companies in the United States

and a chronic corporate criminal offender. Waste Management controls approximately 22 percent of North American waste business. This includes the transport of millions of tons of waste on roads and waterways to waste disposal landfills in Virginia and Pennsylvania, the top two importers of trash, primarily from New York, Washington, D.C., and Delaware. WMI was sued but recently settled out of court with the state of Virginia for violating the state's environmental waste transport laws that prohibited water transport of waste. WMI can legally use barges to transport interstate waste to Virginia. Virginia was one of the first states that tried to protect its waterways from exposure to waste, however a federal court struck down the state law.

### MINORITY NEIGHBORHOODS

WMI operates a landfill in Sun Valley, California, where residents sought in the early 2000s to stop the company's landfill expansion. Expansion plans would increase the amount of waste in the landfill from 1 million to 3.3 million cubic yards. Critics say WMI, like other waste companies, often exploits geographic areas like this one that involve lower costs and where resident resistance is less powerful. Typically, this often involves placement of facilities in poor or predominately minority neighborhoods.

From 1970 to 2004, Waste Management was criminally convicted 10 times and was fined over \$5 million. Additionally, it was convicted of 23 price-fixing crimes in 23 states, and has violated 22 environmental regulations and 87 other administrative regulations. WMI also was found guilty of defrauding its investors. In a civil settlement, Waste Management was forced to pay \$220 million in damages for lying about its earnings to inflate its stock prices.

In 2002, the Securities and Exchange Commission (SEC) filed a lawsuit against former executives of the company for inflating earnings by almost \$2 million, an accounting fraud scheme designed to deceive shareholders. The accounting firm, Arthur Anderson, assisted in perpetrating the fraud and as with Enron Corporation, also destroyed the paper trail of evidence in the fraud. The lawsuit alleged that WMI defrauded shareholders of more than \$6 million.

Meanwhile, Waste Management announced in February 2003 that it was cutting full-time jobs and contracts across North America and expanding its

operations globally. Like the early predecessors in the cartage or garbage industry that were owned and operated by a number of organized crime families, WMI also was convicted of price-fixing charges in Wisconsin and California and pleaded no contest to similar charges in Florida and Georgia. It has also settled out of a court a class action lawsuit for price fixing in a number of local markets, paying over \$50 million. WMI was also sued by the town of South Elgin, Illinois, for trying to open a waste transfer station on top of a closed landfill that it had previously promised to not expand in 1988.

In the wake of the company's international expansion, one WMI subsidiary, Waste Management Siam Limited, is headquartered in Thailand. This plant is the first Thai facility to be owned by private investors rather than the state, and currently has the capacity to process 2 million cubic meters of waste.

Forty percent of the plant's waste revenues come from the United States, 40 percent from Japan, 15 percent from other countries, and only 5 percent from Thailand. Much of the current waste dumped in Thailand is dumped illegally. Clearly, states appear to make more money (or no money) by storing other people's garbage rather than their own, or illegally receiving it without any safety measures to protect the environment or the people.

### SEE ALSO

water pollution; air pollution; hazardous waste; Environmental Protection Agency.

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## water pollution

POLLUTING THE WATER in the United States is an environmental crime. The Environmental Protection Agency (EPA) monitors and regulates approximately 80 chemicals in finished drinking water as stipulated by the Safe Drinking Water Act. When analyzed samples contain the specified chemicals above a preset maximum contamination level, then the water is considered unsafe.

Corporations are chronic offenders in this category of white-collar crime. Some of the biggest corporate offenders of such environmental crimes include, General Electric (GE), Westinghouse, Ford, DuPont, the U.S. government, and Union Carbide. Estimates are that corporations illegally dump about 8 million tons of toxic wastes into rivers and coastal waters annually.

As just one example from the industrial polluters list, during the 1950s, General Electric's two manufacturing plants in New York, one at Fort Edward and the other at Hudson Falls made electrical capacitors for electricity plants. A capacitor saves electric companies' money by producing more electricity with less power or amps. However, these capacitors only work because of the use of polychlorinated biphenyls or PCBs. Monsanto developed PCBs in 1929, and in 1970 Monsanto warned GE to keep PCBs from entering the environment. PCBs are listed as a persistent organic pollutant that does not break down over time. A variety of research also shows that PCBs are carcinogenic, cause birth defects, miscarriages, and cloracne (a severe skin disease that covers the body with pustules and darkens the skin), impairs vision, leads to impotence, fever, and diarrhea.

Both GE plants began dumping the castings used to make the capacitors, covered with PCBs, into the Hudson River. The Hudson at the time provided drinking water, commercial fishing, and recreational fishing to the local population. It is estimated that over 500,000 pounds of PCBs were dumped into the river. GE also had a policy to sell or give away PCB contaminated dirt, including selling it as fertilizer. One such place is the Dewey Loeffel Landfill in Nassau, New York, where GE dumped more than 46,000 tons of PCBs, other heavy metals, and toxic wastes in the 1950s and 1960s. This is more than twice the amount dumped at the Love Canal, New York, catastrophe in 1984 in what is referred to as the worst industrial acci-

dent on record. The Dewey site continues to be classified as a significant health risk by the state of New York.

Pollution of the Hudson continued until 1975 when the Clean Water Act began to be enforced. Subsequently, the federal government ordered the company to begin to reduce the amount of PCBs released into the Hudson. In 1976, the U.S. Congress outlawed PCB manufacture, sale, and distribution (except in "totally enclosed systems"). Finally, GE agreed to pay \$3 million to clean up the Hudson and to discontinue use of PCB by the year 1977. Since that time, GE has managed to get 77 of its plant sites on the EPA Superfund list, areas that must be cleaned up as the result of severe pollution. Superfund sites are contaminated areas requiring cleanup by the company that did the polluting whether or not the pollution was legal at the time. The Comprehensive Environmental Response, Compensation and Liability Act created such sites in 1980.

### POLAR BEARS TO DOLPHINS

At least 500,000 pounds of PCBs are estimated to still set at the bottom of the Hudson. In the early 2000s, the EPA had a five-year plan to complete a dredging program aimed at removing 2.65 million cubic yards or 100,000 pounds of PCBs from the Hudson River. The cost was estimated at \$460 million dollars. Fish still remain contaminated and unsafe to eat, and on land, animals such river otters, turtles and mink also have high levels of PCBs in their bodies. As far as 40 miles away from GE's two plants, PCBs were also being found in water falling from the Troy Dam. Moreover, PCBs have been found higher up the food chain in polar bears and dolphins and in human tissue and blood samples.

GE has spent millions fighting the government and unsuccessfully refuting these research findings while donating millions of dollars to local communities to garner support for a no-dredge or no-clean up order. Nonetheless, the EPA made a decision in 2002 requiring GE through the Superfund program to clean up the Hudson River. There are at least 40 sites along the river that are contaminated with PCBs, 13 of which have been designated as a "threat to public health or the environment" by the New York Department of Environmental Conservation.

GE also has similar sites like the Hudson River plants in Pittsfield, Massachusetts, and Rome,

Georgia, communities with similar pollution problems and clean up mandates.

## HAZARDOUS WASTES

What may begin as air pollution at work, may also result in groundwater pollution. A company called Rentokil Wood Preserving Division in Henrico County, Virginia, treated wood with chemicals from 1957 until 1990 when the plant was closed. Employees were regularly unprotected from a variety of airborne chemicals that were used to treat the wood, including copper arsenate (CCA), creosote, chromated zinc arsenate, pentachlorophenol (PCP), xylene, and fire retardants in solutions of ammonium phosphates and sulfates from 1982-1990. Until 1980, these chemicals dripped from the treated wood into the ground. Employees also reported that similar wastes were discharged into a sump from 1957 through 1963. CCA was also dumped into a ditch near the company during the mid 1970s.

Additionally, hazardous waste was generally put in drums and buried on the property for many years as well as dumped openly into the soil. Several employees (the company only employed 20 people) developed cancer after working for many years at the plant. Carcinogenic chemicals were discovered in excess of the mandated levels in the soil, and groundwater near the plant. These included PCPs, polynuclear aromatic hydrocarbons, dioxins, zinc, and furans. While the authors of one study report that an appropriate negotiation process for the clean up of this site followed, the EPA really capitulated to pressure from the industry. The company was allowed to use the cheapest method of clean up involving capping the materials in the ground and then allowing for the re-development of the land (including a playground). From discovery in 1982 to clean up, this Superfund project took 17 years to complete at a cost of \$15.5 million.

Similarly, Union Carbide is also responsible for water pollution. In Ocean County, New Jersey, between 1979 and 1991, a number of underground water wells became contaminated from a Union Carbide Superfund site. The site had been used for the disposal of industrial waste beginning in 1971 and was later condemned after leaking was discovered in 1975. In 1987, the same volatile organic pollutants that are known to be carcinogenic and were in the Superfund site were also found in the water.

The groundwater underneath the Superfund site was collected by two of the wells that provided water to the community.

## INTERNATIONAL WATERS

Internationally, the World Health Organization estimates that a lack of safe water kills over two million people each year. While some of this is simply due to poor sanitation, much of it is also the result of polluting Western industries taking advantage of third world nations with lax environmental laws. For example, a study recently completed in Taiwan found that exposure to contaminated groundwater was associated with cancer risks for 382 residents of several communities. These communities were located from near the site of a former electronic appliance factory responsible for on-site soil and underground water contamination over a 10-year period. The Taiwan EPA declared the area a hazardous waste site in 1994. A variety of distinct types of chemicals were found at the Taiwan site and are referred to generally as chlorinated hydrocarbons associated with increased risk for liver cancer. Sixty-one percent of the problems associated with liver cancer were the result of inhaling the chemicals during showering (local residents boiled their water thus eliminating carcinogenic risks from contamination).

In 2002, the United Nations (UN) Committee on Economic, Social and Cultural Rights declared access to safe, sufficient, physically accessible and affordable water to be a human right. The UN goal is to decrease by half the number of people who still do not have access to clean water around the globe by 2015.

### SEE ALSO

Environmental Protection Agency; air pollution; General Electric; Love Canal; Clean Water Act.

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## Watergate

THE WATERGATE scandal generally refers to all offenses committed during the Richard Nixon administration. The unraveling of the Watergate incident originally pursued by investigative reporters Carl Bernstein and Bob Woodward of the *Washington Post* led to the revelation of extensive illegal acts by members of the White House staff and others closely associated with, or employed by the Nixon administration. As a totality of all crimes by the Nixon administration, Watergate is better understood broken down into three phases.

The first includes illegal acts sanctioned by the White House prior to the break-in at Democratic National Campaign (DNC) headquarters in the Watergate apartment complex in Washington, D.C. Second is the Watergate burglary itself which was a failed attempt to tap the telephone lines of the DNC chairman on June 17, 1972. Third is the conspiracy to cover up the Watergate burglary and prevent any connection between it and the White House from being discovered.

The question was how much did Nixon know about the plan before its commission? The notion Nixon may have had prior knowledge of the burglary seems plausible by the fact that the Watergate burglary was not the only one associated with his administration. The burglary of Daniel Ellsberg's psychiatrist's office preceded Watergate, and involved some of the same people who played subsequent roles in Watergate. (Moreover, in 2003, one

of the indicted participants in the Watergate scandal, Jeb Stuart Magruder, told a Public Broadcasting Service reporter that Nixon, indeed, had authorized the plan for the Watergate break-in.)

As a Defense Department consultant who personally supported the War, Ellsberg was commissioned by the Rand Corporation to write a history of U.S. involvement in the conflict, *The Pentagon Papers*. The publication of the *Papers* infuriated Nixon because they could appear to imply he was not handling the war as promised. To identify the source of the *Papers* leak and to prevent others in the White House from leaking information, Nixon created a special investigative unit known as the Plumbers under the supervision of John Ehrlichman with Egil Krogh in charge. The Plumbers unit included G. Gordon Liddy and E. Howard Hunt. They identified Ellsberg to be responsible for leaking the *Papers* to the press. Liddy and Hunt were put in charge of burglarizing Ellsberg's psychiatrist's office to obtain incriminating information.

Many other factors played a part leading up to the Watergate break-in that make an explanation of it much more complex than a simple order from the president. The overall mentality of the Nixon administration was a factor. Nixon's goal in anything he undertook was to win at all costs. This went so far as placing anyone who opposed him, or who was unfriendly, on the White House "enemies list." In such an environment subordinates felt secure in doing just about anything to attain presidential goals, even if the actions were unethical or illegal.

The win-at-all-costs outlook, and certain amount of paranoia about leaks, certainly would shape the thinking and acts of Nixon's campaign officials. Unlike previous presidential incumbents up for re-election, Nixon did not leave his campaign to his party, but instead created the Committee to Re-elect the President (CREEP). CREEP was devoted entirely to ensuring Nixon's re-election. John Mitchell, attorney general of the United States, was appointed to head CREEP with Magruder serving as deputy director. Mitchell reported to John Dean III, White House counsel, who in turn reported to H. R. "Bob" Haldeman the White House chief of staff. Rather than focusing on publicity and raising campaign contributions, CREEP set about to gather political intelligence.

The idea to break into Democratic headquarters was possibly suggested to John Mitchell by G. Gordon Liddy CREEP's "intelligence chief." The

object was to wiretap the telephone line of Larry O'Brien, the DNC chairman, to gather intelligence on the Democrats' campaign strategy. As the persons in charge of the operation Liddy and Hunt directed the burglary from a hotel room across the street from the Watergate apartment complex. On night of June 17, five burglars, Bernard L. Barker, Virgilio Gonzalez, Eugenio R. Martinez, Frank A. Sturgis, and James W. McCord (CREEP's security consultant) entered the DNC offices. A security guard noticed a taped-open door and lights, and called police. The day after the burglary, Ehrlichman, Haldeman, and the president were informed of the ill-fated attempt. Nixon was extremely aggravated at his subordinates' failure, but referred to the incident as "the caper." The burglary and additional crimes the investigation exposed led to Nixon's resignation as president of the United States on August 9, 1974.

#### CENTER OF THE PLOT

Two points of law made Nixon culpable. First, laws on criminal conspiracy state if someone becomes aware of a plan to commit crime and takes action to further it, he is culpable because the actions place him among the plotters, and can thus be criminally charged. He also ordered the Federal Bureau of Investigation to stop inquiries into the Watergate burglary thus obstructing justice. Second, one must have something to gain or an interest in the object of the conspiracy. A burglary aimed at ensuring Nixon's re-election placed his personal interests at the center of the plot.

The case of the *United States v. Mitchell et. al.* began January 8, 1973, before Judge John J. Sirica. The Watergate incident, as a whole, resulted in the indictment of more than 40 of Nixon's subordinates and supporters. Each served minimal time, with Liddy serving the longest actual sentence of four years. President Gerald Ford pardoned Nixon, arguing that losing the presidency was punishment enough and a prison term would serve no purpose.

#### SEE ALSO

elite crime; Nixon, Richard M; corruption.

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## Weisburd, David (1947–)

IN 2003, David Weisburd was a professor and senior research fellow in the department of criminology and criminal justice at the University of Maryland, a position held since 2000. Weisburd also held a joint appointment at the Institute of Criminology at the Hebrew University in Jerusalem, Israel, where he was on the faculty of law. Weisburd obtained his Ph.D. in sociology at Yale University, where he also earned a Master of Philosophy degree in sociology, and a M.A. in sociology. Weisburd earned his B.A. degree in sociology from Brandeis University.

Before his 2003 academic position, Weisburd held a number of posts and visiting positions in the field of criminology and criminal justice, including as a research associate on the well-known Yale Studies in White-Collar Crime at Yale Law School during the periods of 1979–81 and again in 1983–84.

Weisburd has conducted research in several distinct criminal justice topics, including policing, research, and statistical methods, and white-collar crime. He has received numerous grants and fellowships to support his individual and collaborative research projects. One such project was an extensive, National Institute of Justice-funded study to assess sanctioning effects in the area of white-collar criminal careers, under which he served as a co-principal investigator with Ellen Chayet. The research examined whether white-collar offenders shared the characteristics commonly associated with the career criminal and criminal career paradigms, such as onset, prevalence, specialization in offending, frequency of offending, and duration of offending.

This unique study was the first of its kind in white-collar crime, and contributed to a number of

significant journal articles and books. Some of his major contributions in this area of research include *White-Collar Crime and Criminal Careers* (co-authored with Elin Waring and Ellen Chayet in 2001); *White-Collar Crime Reconsidered* (co-edited with Kip Schlegel in 1992); and *Crimes of the Middle Classes: White-Collar Offenders in the Federal Courts* (co-authored with Stanton Wheeler, Elin Waring, and Nancy Bode in 1991).

#### SEE ALSO

Wheeler, Stanton; differential association theory; self-control theory; Sutherland, Edwin H.

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## Wheeler, Stanton (1930–)

IN 2003, Stanton Wheeler was a Ford Foundation professor emeritus of law and the social sciences and professorial lecturer in law at Yale University Law School. Although he is well known for his research contributions in areas such as administration of justice, white-collar crime, and sociology of law, Wheeler's research has also included the areas of sports and law as well as music and law.

Wheeler began his education at Pomona College, where he graduated with a B.A. in 1952. Subsequently, he enrolled in graduate school at the University of Washington in Seattle, where he earned a M.A. in sociology in 1956, followed by a Ph.D. in 1958. Before joining the faculty at Yale, Wheeler's professional and academic positions including assistant professor in the department of social relations at Harvard University (1961–63). While employed at Harvard, Wheeler was also a Fulbright research scholar at the Institutes of Sociology and Criminology, University of Oslo, Norway, where he served from 1960 to 1961. Wheeler

has also held many official positions related to his research, such as a member of many journals' editorial boards.

Wheeler is the author of numerous books and articles based on his funded research. His major writings on white-collar crime emerged during the course of his direction of the largest-ever research study on white-collar crime, the Yale Studies. For students of white-collar crime, the Yale Studies have provided some of the most influential findings in the field. From 1983 to 1991, Wheeler directed the project, and served as the general editor of *Yale Studies in White-Collar Crime*, a series of books that reported the major findings from the research project. A series of articles based on preliminary findings from the project were also published, and the data from the studies have been re-analyzed by several other researchers.

The topics of the Yale series books are related, but each investigates a unique area of interest to white-collar crime researchers, such as offender characteristics, theory, and sentencing and punishment. In 1988, Wheeler (along with Kenneth Mann and Austin Sarat) published *Sitting in Judgment: The Sentencing of White-Collar Criminals*. This book summarizes and discusses comprehensive interviews of federal district court judges. Another significant contribution in the series is *Crimes of the Middle Classes: White-Collar Offenders in the Federal Courts*, which Wheeler co-authored with David Weisburd, Elin Waring, and Nancy Bode in 1991. Perhaps most notable of its findings, this book revealed that the larger portion of white-collar crime is not committed by upper-class individuals, as commonly assumed, but instead by those offenders who can be described as "ordinary people."

Examination of the sentencing data showed that common offenders still received harsher sanctions than white-collar offenders, a finding that supported previous ideas. Common offenders were also more likely to lose their jobs after sentencing. The major policy lesson learned from this book is that white-collar crime can be reduced through procedures that reduce temptation and also make it difficult to accumulate debt.

#### SEE ALSO

Sutherland, Edwin H.; differential association theory.

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## whistleblowers

THE ORIGINS OF whistleblowing have been compared to English common law notions of raising the “hue and cry” to create a public uproar when a crime was discovered. Other scholars have traced the term to a referee who blows the whistle to halt action or to a police officer who blows a whistle and yells “stop thief.” Gerald Vinten notes that the first known use of the term was in reference to the 1963 Otto Otopka case.

Otopka provided classified documents concerning security risks to the U.S. Senate Subcommittee on Internal Security that resulted in the firing of the Secretary of State Dean Rusk. Whistleblowing is defined under the Whistleblower Protection Act as the “disclosure of information that an employee reasonably believes is evidence of illegality, gross waste, gross mismanagement, abuse of power, or substantial and specific danger to public health or safety.”

The efforts of whistleblowers have resulted in the exposure of dangerous workplace environments and deviant organizational practices that have served as the impetus for major organizational changes and government prosecutions of malfeasance. Infamous whistleblowers include, for example, Frank Serpico who reported widespread corruption in the New York City police department in the late 1960s. Ernest Fitzgerald was fired by the Pentagon in the 1970s after he revealed a billion-dollar waste overrun on military aircraft contracts.

In 2002, *Time* magazine named three whistleblowers as Persons of the Year. Sherron Watkins was a vice president at Enron who first warned the chairman of improper accounting methods. Coleen Rowley was a Federal Bureau of Investigation (FBI) staff attorney who reported negligence within the

agency on the investigation of a man who later was charged as a co-conspirator in the September 11, 2003, terrorist attacks. Cynthia Cooper helped uncover WorldCom’s attempt to cover up \$3.8 billion in losses when she informed the company’s board members of the “creative” accounting. Though these whistleblowers have been designated heroes for uncovering fraud and malfeasance, traditionally, companies and colleagues have viewed employees who report wrongdoing as disloyal rats who are prone to tattle-telling.

Motives of whistleblowers often are difficult to disentangle from the circumstances and complexities surrounding each unique case. While the motivations and ethics of whistleblowing often are difficult to generalize, similarities are noted in the literature. Researchers have discovered that whistleblowers are likely to have a high level of moral development, high self-esteem, and an internal locus of control. Whistleblowers consider themselves loyal employees who are committed to their organizations. Often, they have attempted to rectify the situation through internal reporting, but as a result of the negative labels and retaliation resort to external sources. When deciding to report, observers of illegal or immoral actions also consider the personal costs of reporting.

In certain circumstances, whistleblowers pay a high price for dissenting. They may suffer retaliation through demotions or firing. Their family life may be disrupted; they can become targets of scorn and be alienated from friends and colleagues. Research suggests that retaliation is more likely to occur when the reported wrongdoing harms the organization, hurts the public, or when the illegal activity continues despite complaints. Organizations typically discourage and resist recognition of whistleblowers; consequently, their decision to report wrongdoing through external channels often result in public scandals that further damage the reputation of the organization.

Efforts to legitimize the reporting of workplace malfeasance through legislation appear to have little effect on eradicating views that whistleblowing is a pejorative act. The False Claims Act (FCA) protects employees from retaliation and allows private citizens who suspect fraud to file suit on behalf of the government. The FCA was enacted during the Civil War to control fraud in government contracts. Whistleblower protection can be found in 35 federal laws and in individual state legislation—the

FCA represents the most effective source for recovery and protection from retaliation.

A *qui tam* suit involves private individuals who sue on behalf of the government to recover damages for criminal or fraudulent actions. *Qui tam* is Latin for "he who brings an action for the king as well as for himself." The whistleblower complaint is filed under seal in the U.S. District Court. The Justice Department then has 60 days to investigate the allegations and decide whether or not to join in the lawsuit. The Government Accountability Project, which has defended thousands of whistleblowers against retaliation, however, warns of the odds of profiting from a whistleblower claim are similar to those of winning a lottery. As of late 2001, the Department of Justice (DOJ) reported that 3,194 *qui tam* cases have been filed since 1986. Ninety-five percent of the cases in which DOJ intervened resulted in some type of monetary recovery. Through September 2000 the total recovered reached \$5.204 billion.

#### SEE ALSO

corporate liability; Witness and Victim Protection Act; differential association theory.

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## Whitewater

THE TERM *Whitewater* has two meanings. In its literal sense, it refers to the Whitewater Development Corporation, an unsuccessful real estate partnership between former president and first lady Bill and Hillary Clinton and James and Linda McDougal to develop a resort on the White River in Arkansas. In its broader sense, *Whitewater* was a

partisan attempt to use a "scandal" to bring down a president.

The real estate deal can only be understood in the deregulation environment of the 1980s in what became known as the "me decade." The "scandal" makes sense only in the highly charged environment of political campaigns and subsequent partisan attacks on a political opponent. Within the context of *Whitewater*, neither Bill nor Hillary Clinton was ever found guilty of anything worse than misjudgment. The investigations never proved that Arkansas Governor Clinton (at the time of the *Whitewater* transactions) used his position to help the McDougals. Nor did it prove that either of the Clintons engaged in a cover-up. Clinton opponents maintain that the Clintons lied, and even some Clinton supporters believe that both Clintons should have been more forthcoming on details of *Whitewater*.

James and Susan McDougal, who allegedly illegally diverted over \$17 million from Madison Guaranty funds, were convicted on charges of conspiracy and mail fraud. James McDougal died in prison in 1998. Susan McDougal was also charged with contempt because she would not provide requested information on the Clintons. Arkansas Governor Guy Tucker was also convicted of conspiracy and fraud.

In an unsecured loan, the Union National Bank of Arkansas provided the Clintons \$20,000 to invest in the deal to turn 230 acres of undeveloped land into a resort. The Citizen's Bank and Trust of Arkansas financed an additional \$182,000 for the *Whitewater* Development Corporation to buy the land, which the president of the bank owned. Even though the McDougals put up most the money involved, the Clintons were considered equal partners.

In the early 1990s, investigations began into various failed savings and loan institutions (S&Ls), which had cost the taxpayers millions of dollars. Charged with investigating the S&L scandals, the Resolution Trust Corporation examined Madison Guaranty Savings and Loan in Arkansas, which had collapsed in 1989 and which was owned by James and Susan McDougal. Even after filing for bankruptcy, Madison Guaranty continued to make payments to the *Whitewater* account. Initially, the Clintons were seen as witnesses against the McDougals; but as details about the partnership were made public, the media and Clinton critics called

for hearings into the Clinton's finances. Matters were complicated by the fact that Hillary Clinton had served as the lawyer for Madison Guaranty Savings and Loan, and more complications arose when Vince Foster, White House counsel and guardian of the Clinton's personal financial papers, committed suicide in July 1993 under mysterious circumstances.

After both the Senate and House Banking Committees held hearings on Whitewater, Kenneth Starr, a staunch Republican, was appointed as independent counsel to investigate the Clinton connection to Whitewater. Starr extended his investigation to include information about Bill Clinton's sexual activities. Ultimately, the House of Representatives impeached the president on charges that arose from Starr's investigation.

#### SEE ALSO

investment trust scandals; Clinton, William J.

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## wire fraud

THE FEDERAL WIRE fraud statute, originally enacted in 1952, is codified under 18 U.S.C. §1343, and has two essential elements: 1) using, or trying to use, signal transmission that occurs in interstate or foreign commerce; 2) transmission that is in furtherance of defrauding someone.

The law has been utilized against virtually every new electronic method of fraud as well as less sophisticated schemes. Federal jurisdiction over wire fraud originates in the Constitution under Article 1, Section 8, and is based on Congress's right to make

laws affecting interstate and foreign commerce. It is titled *Fraud By Wire, Radio, or Television*:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than five years, or both. If the violation affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

Many of the legal theories associated with the application of the mail fraud statute (18 U.S.C. 1341) are also applicable to wire fraud. One major difference between wire and mail fraud is that the federal government can criminalize any use or intended use of the mails both interstate and intrastate, according to its right to regulate the post office, which it owns and operates. In contrast, the federal government does not own the wires over which fraud is conducted and therefore is not allowed to criminalize intrastate wire use. It is restricted by the Commerce Clause to criminalize only wire transmissions that affect interstate and foreign commerce.

Four years after its passage, Congress changed the statute to explicitly reflect the federal jurisdictional criterion and to eliminate any challenges to the law based on constitutionality. The change involved substituting "transmitted by means of wire, radio, or television communication in interstate or foreign commerce" for the original statutory wording of "transmitted by means of interstate wire, radio, or television communication." The other major revision of the statute occurred in 1989 when the clause related to effects on a financial institution was added, and for which the maximum punishment was increased by 10 years in 1990.

The underlying legal crime of wire fraud is not that associated with the fraud, but rather the crime in using wires or signals in interstate or foreign commerce, or trying to use them, as an instrument of crime. This allows extremely distinctive enforcement interpretations. First, the statute does not

consider the harm inflicted by the fraud. Rather, it cares only about how many times signals were used, or were tried, in interstate or foreign commerce to in any way further the fraud.

Second, the statute allows merely a “scheme” to be prosecuted, regardless of whether the fraud actually took place. The interpretation is in this sense similar to a conspiracy to commit a crime, but a conspiracy necessitates at least two participants; there need be only one participant in the scheme to be prosecuted under wire fraud. Further, whereas conspiracy can be charged only once, wire fraud law punishes each act of signal transmission as a separate count.

## ENOUGH TO CONVICT

The intent to violate §1343 only need involve a broadly interpreted “foreseeable” use of wires or radio/television signals, and the offender need not even have foreseen their use in interstate or foreign commerce. In one case, for instance, there was a fraud-related Western Union communication between two small cities in Texas, but the message happened to be routed, as were all such communications, through West Virginia. Even though the defendant did not “foresee” the use of wires in interstate or foreign commerce, he should have foreseen at least the use of wires, which is enough to convict. This broad interpretation of “foreseeing” is especially idiosyncratic to both mail and wire fraud statutes, because most offenses require that the perpetrator have knowledge of the commission of the act and also intends its commission.

Wire fraud must go beyond obtaining something under false pretenses and include harm to victims. An illustrative case involved employees of an office-supply company who lied to potential customers when they sold stationery over the telephone, by stating that they were physicians who needed to dispose of unwanted supplies, or that the goods to be sold belonged to a friend who had died. Because the goods were delivered, as promised for the agreed price, no harm, and therefore no fraud, was found, despite the creative false pretenses under which the sales were made. Wire fraud, then, must involve the use of false pretenses.

For many years, §1343 was interpreted as covering bribe-taking by officials and private citizens who used wires or signals in interstate commerce to effect the bribery scheme. The legal basis was that the

bribe-takers were depriving others of their intangible right for honest services. This prosecutorial basis for wire fraud was overturned by the Supreme Court in 1987, because the fraud did not necessarily involve an intent to deprive a person of property or property rights. In 1988, Congress responded by passing 18 U.S.C. §1346, which explicitly defined wire and mail fraud in terms of depriving a person of her intangible right to honest services. In 1994, Congress passed 18 USC §2326, which added as many as five years to the punishment of federal wire and mail frauds associated with a telemarketing scheme, including the unauthorized use of identity, credit card, or bank information gained from telemarketing. If the telemarketing either victimized more than 10 persons over 55 years of age, or generally targeted those seniors, then the penalty for these federal frauds could be increased by as many as 10 years.

Another statute related to wire fraud, 18 USC §1029, was passed in 1984 and concerns the use of any card, device, or code that is used in fraudulent credit card or bank account schemes, many of which involve wire or signals in interstate commerce. Using electronic scanners to intercept signals for fraudulent purposes or using equipment to receive unauthorized telecommunication services are also punishable under §1029.

## SEE ALSO

mail fraud; telemarketing fraud; Federal Trade Commission; credit card fraud.

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## Witness and Victim Protection Act

IN 1982, Congress initiated the Victim and Witness Protection Act (VWPA) as a means of providing restitution for victims of financial crimes. With the

passing of this act, federal courts are allowed to provide for victims of crimes by sanctioning the defendant with fines directly intended for the victim. This differs from prior legislation in that traditionally fines were paid to the court and then used to offset court costs, fees, and other legal costs. Under the modifications provided by the VWPA, victims of crimes are entitled to receive compensation for their pain, suffering, or loss.

While victim restitution is one of the more important aspects of the act, it is not for restitution that the act is best known. Rather, it is the witness protection clauses that have received the most notable attention. Sections 1512 and 1513 allow for the protection of witnesses, potential witnesses, notable investigators, and any other individual who testifies against a defendant and then fears for their safety or life.

The protection extended to witnesses is twofold. Witnesses are provided protection from coercion during the trial and are occasionally provided protection after the trial. Traditionally, the witness was protected during the trial from any form of knowing intimidation, threat, misleading conduct or coercion that was accomplished through threat of physical force. However, tampering with a witness, as prohibited by section 1512, has been extended to acts other than physical force and includes acts that could be interpreted as an attempt to bribe a witness to change her testimony or refuse to present evidence at trial.

Interestingly, the government is not required to provide evidence that a defendant was successful in coercing a witness into failing to testify. The prosecution must only prove that acts took place that could be considered threatening or coercive. Should the coercion of the witness be successful, and the prosecution can demonstrate that the defendant was aware of the coercion, then the defendant is considered to have vacated his right to face his accuser and may not challenge the admission of statements made by a witness prior to the coercion. This is an important consideration because of the traditional ban on the admission of hearsay statements, which are statements made outside the court that cannot be confirmed through the questioning of the individual who made the statement.

In an effort to prevent a witness from being coerced, or physically harmed, witnesses who are preparing for trial are provided with around-the-clock security. The witness is normally housed at an

unknown location during the trial, and once the trial is completed the witness is given several choices; whether the choices are offered is contingent upon several factors such as the importance of the witness and the nature of the prosecution.

If the court determines that the defendant is not a threat to the safety of the witness, or if the witness declines to accept continued federal protection, then the witness is released into her own custody. If, however, the court determines that the defendant, or perhaps individuals who work with or for the defendant, pose a threat to the safety of a witness, and the individual in question desires protection, then the individual is placed into the protective custody of the Witness Protection Program with a new identity. The use of the Witness Protection Program is rather expensive and is therefore normally reserved for cases that involve serious violent criminal acts and defendants who are believed to be capable of causing harm to a witness either during or after their incarceration.

#### SEE ALSO

prosecution; sentencing guidelines; Justice, Department of; United States.

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## workplace deaths

IN 2001, 5,900 people in the United States were killed at work. The ways people died included motor vehicle deaths, accidents with machines, falls, being struck by objects, electrocutions, and homicides. The number of workplace homicides (the killing of one human being by another) was the lowest since the federal Occupational Health and Safety Administration (OSHA) began collecting data on workplace homicides.

To fully understand workplace homicides, it is necessary to consider the characteristics of the of-

fenses, victims, and offenders; the causes of workplace homicide; reasons for decreases in workplace homicides; and strategies to deal with offenses.

A number common patterns have been found in workplace violence cases. For instance, offenders and victims tend to be males. According to the Department of Justice (2001), between 1993 and 1999, 80 percent of victims were males. Victims also tend to be between the ages of 25 and 44, as do offenders in these cases. Also, guns are used in 86 percent of the cases and robbery is the most common motive in workplace homicides, according to the Office of Victims of Crime (2001). Taxi cab drivers have the highest risk of workplace homicide. In fact, in the mid-1990s, they were 60 times more likely to be killed at work than the rest of the population.

In *Workplace Homicide: A Continuum from Threat to Death*, criminologist Mittie Southerland and her co-authors identify the following possible causes of workplace homicides. These causes include: 1) low self-control theory, 2) routine activities theory, 3) strain theory, and 4) domestic violence theory.

Low self-control theory suggests that individuals with low self-controls are more likely to commit crime than are those with high self-controls. Routine activities theory assumes that victims are engaged in normal activities and a level of vulnerability and risk may increase the likelihood of victimization. According to this theory, three elements must be present for a crime to occur: 1) a motivated offender, 2) a suitable target, and 3) the absence of a capable guardian. Strain theory is traced to sociologist Robert Merton who argued that individuals work to attain goals by any means set by society.

Domestic violence theory considers the way that intimates commit workplace homicides against their partners. Violence is believed to be a loss of control and the aggressor feels disobeyed or rejected. Tying in routine activities theory, the offender knows the victim's whereabouts at all times when she is at work. Indeed, when domestic violence is the source of the workplace homicide, it is usually a man killing a woman.

In addition to these causes, other authors have identified certain themes that address some reason why these offenses occur. Kelly McMurry (1996) stresses that 75 percent of workplace homicides are robbery-related, while just 9 percent of homicides outside of the workplace are robbery-related. The

study further points out that victims who are at risk are those who work alone, work very late, have a great deal of contact with the public, and exchange money. T.S. Duncan, in the article "Death in the Office," (1995) identifies some other themes that help to explain workplace offenses. The article suggests that these offenses more often involve: 1) a man with a gun, 2) a man with a mid-life crisis, 3) disgruntled employees, 4) civil servants, and 5) offenders who are suicidal.

The number of workplace homicides decreased in the late 1990s. In full, workplace homicides decreased 44 percent in the 1990s, a significant measure. Two explanations for these changes exist: organizational changes and structural factors. Organizational changes have to do with things that companies did in response to the high workplace homicide rate of the mid-1990s. Companies developed zero-tolerance policies in dealing with workplace violence.

## HAPPY WORKERS

Structural factors look at societal characteristics in an attempt to explain changing crime rates. From this perspective, the trend of workplace violence decreasing in the 1990s and stabilizing into the new decade is not surprising. All types of violence followed the same pattern. Some criminologists attribute violence rates to the percentage of 18- to 21-year-olds in the population. More young people means more violence. This, however, would not necessarily explain the changes in workplace violence. One explanation for the changes in the workplace could stem from the changes in the economy; better economy, happier workers; struggling economy, less happy workers.

Three separate strategies have been used to prevent workplace violence: careful hiring practices, environmental changes, and training. With regard to careful hiring practices, companies have strengthened their background checks, drug tests, and other procedures designed to determine who has a propensity toward violence. These measures are believed to protect workers from violence perpetrated by fellow workers.

Environmental changes refer to changes that are made to the physical structure where the business is located in order to protect workers. Training has been another strategy used to prevent workplace homicides. Some experts recommend that training

should focus on decision-making drills and skills training. A growing number of retail outlets have their workers participate in training sessions in which they role-play a robbery. A consultant who conducts workplace violence training session suggests that workers and management should learn how to do the following: understand the causes of workplace violence; understand the consequences of the violence; understand the characteristics of high-risk individuals; understand how to deal with confrontation; understand the costs management experiences; identify the warning signs of workplace violence..

The fact that workplace homicides has decreased significantly in the 1990s is promising. The task at hand is to continue to find ways to make the workplace as safe as possible for workers.

#### SEE ALSO

workplace violence; Occupational Safety and Health Act.

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## workplace violence

WORKPLACE VIOLENCE has become a common occurrence in workplaces across the world. The types of violence range from simple assaults to violent homicides committed against workers. Esti-

mates from the National Institute for Occupational Safety and Health (NIOSH) suggest that nonfatal assaults cost 876,000 lost workdays and \$16 million in lost wages each year.

Workplace-violence incidence can be categorized based on victim-offender relationships or by the actual type of harm inflicted on victims. Researchers at the University of Iowa (2000) have described workplace violence in terms of the victim-offender relationships. Based upon their categorization, they cite four general types of workplace violence.

Type I workplace violence refers to those crimes that are committed as part of a broader criminal act. The offender would have absolutely no personal relationship with the victim. As an illustration, consider instances where offenders harm workers in the process of robberies or other thefts. According to the Iowa researchers, 85 percent of workplace homicides are the result of these sorts of interactions.

Type II workplace violence incidents involve situations in which the offender has a business relationship with the workplace, usually in the form of a customer, consumer, or client. The offender becomes violent during the transaction, and there is generally no other crime committed during these interactions.

Type III incidents refer to those situations in which the offender is a worker in the business. Workers could be violent against fellow workers, their bosses, or their customers. Less than one in 15 of workplace fatalities are committed by employees of a business.

Type IV incidents refer to those that are committed by offenders who have no work relationship with the victims. Consider as an example an offender who commits a violent offense in the workplace against his girlfriend or wife. In *Workplace Violence: A Continuum from Threat to Death*, criminologists Mittie Southerland and her colleagues argue that offenders commit domestic violence in the workplace for two reasons. First, they want to expand or gain control over their victims, and harming them in the workplace allows them to accomplish this. Second, in terms of vulnerability, abusive mates know where their victims are when they are at work. Thus, they know when their partners are at risk.

Violence can also be characterized by the kinds of harm committed by aggressors. These types of

harm include homicides, non-fatal assaults, and sexual assaults. With regard to homicide, NIOSH estimates 20 people are murdered in the workplace every week. These figures mean that homicides are the third-highest cause of death in the workplace in the United States. Some industries are more at risk than others. Police officers, private security guards, and taxi drivers are especially vulnerable.

Non-fatal assaults entail instances in which one individual physically harms another. Attempts to harm individuals are included in this category. It is difficult to estimate the precise extent of assaults occurring in the workplace for a number of reasons. Victims may choose not to report the incident because they may see violence simply as part of the job. Others may be afraid of the abusers and fear losing their jobs. Still others may be afraid of retaliation. There are patterns surrounding reporting decisions. The U.S. Department of Justice (2001) reported that about one-fourth of workplace sexual assaults are reported to the police, about 70 percent of robberies are reported to the police, about two-thirds of aggravated assaults are reported, and about 40 percent of simple assaults occurring in the workplace are reported to the police. In the end, of 2 million workplace crimes committed between 1993 and 1999, 936,000 were not reported to the police.

Despite these obstacles to obtaining an accurate estimate of the extent of abuse, researchers are still able to offer some estimates. According to the U.S. Department of Justice, the following patterns exist in workplace violence incidents: workplace violence offenders are more likely to be white than African-American; 13 out of 1,000 white workers in the workplace were violent between 1993 and 1999, while 10 out of 1,000 African-American workers were violent in the workplace during the same time frame; workplace violence incidents tend to be committed against members of the same race; the victimization rate among private sector and federal government employees is virtually identical; elementary school teachers face a lower risk of violence than do junior and senior high school teachers; males, while making up less than half of the U.S. population.

Researchers have also considered the kinds of strategies used to commit the violence in the workplace. A review of workplace homicides between 1980 and 1992 by NIOSH reveals that over three-fourths of the cases involved guns, 12 percent in-

volved knives or other cutting instruments, 2 percent involved strangulations, and the remaining 10 percent involved an assortment of other strategies.

## CAUSES OF VIOLENCE

Sutherland and colleagues (1997) cite five theories that potentially explain violence occurs in the workplace. First, using the self-control theory, they point out that some workers may have low self-controls. Individuals learn self-control during their childhood from their parents. Those who learn a low self-control as child will, theoretically have a low self-control as an adult. When opportunities present themselves in the workplace, low self-control individuals may respond with violence.

Second, citing the routine activities theory, the authors note that victims can be seen as vulnerable targets who are doing their normal activities during structured times. In cases where offenders have a personal relationship with the victim, offenders are able to be violent because they know the victim's whereabouts. Also tied into the equation is the importance of capable guardians. Victims' risks of workplace violence theoretically decrease when more security is present.

A number of risk factors increase the likelihood that violence will occur in a particular job environment. According to NIOSH, these risk factors include: interacting with the public, exchanging money, delivering goods or services, working late at night or during early morning hours, working alone, guarding valuable goods or property, and dealing with violent people or volatile situations.

Most government agencies have developed guidelines that are designed to prevent workplace violence, as well as policies that dictate their response to such incidents. The Occupational Safety and Health Administration (OSHA) has made a number of recommendations to increase the safety of workers. For instance, OSHA recommends that the companies policy on violence must be communicated clearly to clients, consumers, and employees. This policy should be based on zero-tolerance ideals. They also recommend that workers be trained how to respond to possible violent situations. OSHA also recommends that a reporting policy be developed. Workers should be familiar with the reporting strategies, and ties should be developed with local police and state prosecutors so response mechanisms are in place should violence



occur. Also, companies should provide both crisis intervention and long-term assistance to its employees who are victims of workplace violence. In addition, companies should keep track of the reports of violence so that records are available if they are needed. OSHA also recommends that should violence occur, a comprehensive post-incident evaluation should be conducted.

#### SEE ALSO

workplace deaths; Occupational Safety and Health Act.

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## World War I

AS WORLD War I raged in Europe, President Woodrow Wilson's re-election campaign theme in 1916 was "He kept us out of war." In fact, the United States had already entered the war because American industry had converted in large part to a wartime economy in order to provide Europe with the necessities of war. Initially, the Wilson administration used the incentive of huge profits to encourage American industries to provide the war materials needed in Europe.

While many Americans saw the war effort as a way to help save the world for democracy without giving up its cherished position of neutrality, profiteers and other opportunists viewed World War I as a time of huge profits and unchecked greed. Scholars have estimated that military spending during World War I rose as high as \$11 billion, providing unprecedented opportunities for profiteers. It was often difficult to draw the line between legitimate profits and illegal profiteering; and once the

United States entered World War I in 1918, it became even more incomprehensible that American businessmen and industrialists were getting rich while young men died to protect the capitalist system that fostered profiteering and opportunism.

By 1915, the American public was calling for the establishment of some controls on profiteering. On November 24, 1915, William C. McAdoo, the secretary of the treasury, responded by proposing an income tax bill designed to curb inflated profits. The bill called for a two-cent tax on the production of dynamite, gunpowder, and nitroglycerine. Wilson nixed the tax. In 1917, allegations began surfacing that some American businesses had gone beyond simple profit-making to engaging in criminal profiteering in securing illegal contracts and ignoring government restrictions of war trading.

### WILSON AND PROFITEERING

On May 27, 1918, Wilson addressed a joint session on Congress to warn that "There is such profiteering now, and the information with regard to it is available and indisputable." According to Wilson, profiteers were out of control, and the president received advice on what to do from all sides. Theodore Roosevelt, both a former president and a former assistant secretary of the navy, argued that outfitting the navy was more important than worrying about profiteering. On the other hand, future president and current Food Administrator Herbert Hoover advised Wilson that wartime profits were both unreasonable and unjust.

Within two months of Wilson's address to Congress, the Federal Trade Commission (FTC) issued a report simply entitled "Profiteering," documenting extensive cases of "inordinate greed," "barefaced fraud," deceptive accounting practices, and artificial price inflation that were allowing American industrialists and financiers to become wealthy by exploiting the tragedy of war. The report identified the steel, oil, and gas industries as being particularly responsible for the profiteering problem.

The public was outraged, and even the American Legion called for controls on war profits, suggesting that the government draft war materials rather than purchase them at inflated prices. In the 1924 presidential election, both the Democratic and Republican parties added anti-profiteering planks to their party platforms.

To serve as an incentive to American industry, the government had negotiated contracts on cost-plus-profit basis. The government agreed to reimburse the contractor for all the costs of a project, plus a hefty profit. This plan was beneficial to the government because it saved time to bypass the process of competitive bidding and removed the need for the government to worry about the costs of labor, preparation, and changing prices. On the other hand, it allowed companies to profit at the expense of taxpayers who had seen their wages rise only slightly throughout the war. Because so many young men were at the battlefield and so many young women were involved in a number of war-related occupations, the pool of workers was somewhat diminished. Cases were documented where government contracts were awarded to companies that hired untrained workers who knew little about what they were doing and who sometimes produced low-quality products.

A legal kind of profiteering also occurred after the war when industries were allowed to purchase facilities built on the cost-plus-profit basis for a fraction of what the government had paid for constructing the buildings. For instance, during World War I, the United States government had built a \$14 million facility on land belonging to the New York Shipping Company. After the war, the government allowed the company to purchase the \$14 million facility for \$500,000.

## FINANCIAL PROFITEERING

The munitions industry received a good deal of criticism for profiteering during and after World War I, and some companies were accused of bribing foreign officials to buy their products and of selling munitions to the enemy. The growth of munitions companies during World War I was phenomenal. For instance, Du Pont, the country's largest supplier of munitions and the foremost member of what was known as the "Powder Trust," increased its employees from 5,000 before World War I to over 100,000 by 1919, raking in profits of \$266 million.

John Pierpont Morgan, the son of the noted financier of the same name, epitomized the financier who saw a profit to be made from financing foreign belligerents. His father had left him a \$70 million fortune in 1913, which Morgan more than doubled by the end of World War I. Morgan be-

came a purchasing agent for the British government and negotiated with American suppliers to supplement Britain's dwindling resources. In addition to his banking interests, J.P. Morgan was also the head of United States Steel Corporation. The steel industry took in profits that exceeded those of any other industry during World War I, making an average profit of \$20 million a year.

The outcry against profiteering continued for two decades after World War I ended; and in 1934, the U.S. Senate established a special committee to investigate the munitions industry. The committee was chaired by Gerald P. Nye (R-ND) who had chaired the investigation into the Teapot Dome scandal a decade before. The three-year investigation uncovered extensive proof that profiteering had been rampant throughout World War I. In addition to the Senate Committee's investigation into World War I profiteering, the House of Representatives set up the Graham Committee that also found extensive profiteering during the war. The Graham Committee discovered that taxpayers had lost more than \$78.5 million through excess profits during World War I.

Because the profits from World War I were so enormous and because so many fortunes were made during the war, a number of scholars believe World War I was more about finances than democracy.

## SEE ALSO

war crimes; kickbacks; price-fixing; government contract fraud; government procurement fraud.

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## World War II

FROM THE TIME that Adolf Hitler began the campaign that led to the outbreak of World War II

in Europe in 1939, most Americans realized that U.S. involvement was a distinct possibility. On Sunday morning, December 7, 1941, the Japanese attacked Pearl Harbor in Hawaii with a devastating loss of American lives and property. The following day, President Franklin Roosevelt asked Congress to declare war. From that time until the war ended in August 1945, the United States was in a state of emergency. The president believed that the burdens of war should be shared equally among the population.

While he was sincerely dedicated to eradicating profiteering during World War II, Roosevelt also used anti-profiteering policies to pacify isolationists who used profiteering as one reason for remaining neutral. When FDR sent legislation to Congress asking for increased military spending, it was usually accompanied by legislation for the "prevention of profiteering and equalization of the burdens of a possible war." In October 1942, Roosevelt issued an anti-profiteering executive order limiting personal salaries to \$25,000 after taxes except for movie stars and sports figures, but Congress repealed it the following year. Roosevelt considered and then discarded a 100 percent tax on excess profits. In order to prevent possible cheating in reporting excess profits taxes, around 6,400 federal auditors were employed to monitor tax fraud.

Roosevelt was determined to find ways to curtail profiteering without handicapping the American military. He knew that it was also necessary to differentiate between legal and illegal war profits, while rewarding superior performance in military production. The president charged the Office of War Mobilization with eliminating all illegal war profiteering in the United States. In 1941, the Office of Price Administration (OPA) was created and was given responsibility for preventing speculation, hoarding, profiteering, and price manipulation. Roosevelt believed that controlling wages, rents, and prices would curb inflation and serve to mitigate war profiteering. The chief task of the OPA, therefore, was to stabilize rents and prices and to oversee the quality of war-related materials. The national government used price controls as a major tool in anti-profiteering from 1941 until the end of World War II and pursued violators vigorously.

After price controls were put into effect in the United States, black markets sprang up almost overnight to provide Americans with goods that were rationed or restricted at prices that ignored

legal price limits. Black market goods included meat, tires, gasoline, silk stockings, sugar, refrigerators, automobiles, washing machines, and radios. Because black market goods were illegal, no ration stamps were required to purchase them. The Roosevelt administration established severe penalties for black market activities that included injunctions, fines, and prison sentences.

## WAR PRODUCTION

Between 1940 and 1944, over \$175 billion were awarded in government contracts. In order to meet the needs of a world at war, the U.S. government had to depend on thousands of American businesses to manage production. In 1940, around 175,000 companies controlled 70 percent of the manufacturing output of the United States, with some 100 companies managing the other 30 percent. By 1943, these positions had shifted, with the top 100 companies controlling 70 percent of all production. Within the top 100 companies, one-third of all government contracts went to only ten major corporations. These Top Ten were in unique positions in their relationship to the national government during World War II. Financial benefits were an essential part of the benefits package awarded to the Top Ten in payment for providing essential war goods.

From 1939 to 1945, the federal government covered two-thirds of the \$26 billion spent for constructing new facilities or modernizing existing plants and for purchasing the equipment needed to run those facilities. Privileged companies were allowed to write off major construction and improvements in five years rather than having to wait the traditional 20 to 30 years. In addition to operating their own facilities at government expense during the war, favored companies also operated a number of government-owned facilities with options to buy at reduced costs after the war. On the average, most companies reported World War II earnings from 20 to 40 times that of pre-war earnings. In one case, a company reported a war profit of over 800 percent.

## TRUMAN COMMITTEE

After the election of 1940, Senator Harry Truman, a Democrat from Missouri, was contacted by several constituents who were concerned about the waste, possible fraud, and profiteering that was tak-

ing place on military bases. Truman convinced his Senate colleagues to create the Senate Special Committee to Investigate the National Defense Program, which became known as the Truman Committee. The committee found that many American companies were involved in international cartels that were feathering their nests by dealing either directly or indirectly with the Axis countries. The Truman Committee ultimately saved the government \$15 billion and brought Truman to the forefront of national politics.

## DEALING WITH THE ENEMY

In 1998, the United States Congress passed the Nazi War Disclosure Act, which declassified over three million pages of military and intelligence material. West Germany and the Soviet Union also declassified their World War II files. Together, the records revealed hundreds of incidences where American financial institutions had been secretly involved with financing Hitler's Third Reich either directly or indirectly. For example, the declassified records show that in the fall of 1942, under the Trading with the Enemy Act, Leo T. Crowley, FDR's Alien Property Custodian, seized the assets of the Union Banking Corporation in New York City, along with the assets of several other financial institutions. The files revealed that the Union Banking Corporation was owned by Prescott Bush (the father of future President George H.W. Bush), Prescott Bush's father-in-law George Herbert Walker, Averill Harriman, and several Nazi executives.

In the early 2000s, declassified Central Intelligence Agency documents explained how insurance companies had cooperated with various banks and shipping companies to use neutral countries to engage in illegal relationships with the Axis. Incidences of companies that chose profit over patriotism involved insurance companies that provided the Japanese with material that helped them plan the attack on Pearl Harbor.

## SEE ALSO

military-industrial complex; government procurement fraud; bribery; kickbacks; corruption.

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## WorldCom

DURING THE financial boom of the 1990s, Bernard J. Ebbers, a former basketball coach, bought up a number of telecommunications companies under the WorldCom umbrella. From 1999 to 2000, WorldCom engaged in the largest accounting fraud in history. The company systematically billed billions of dollars of routine business costs as capital expenditures to make it appear that the company was making enormous profits while it was actually losing millions of dollars a year. Investors who bought stocks according to the inflated prices discovered that their stocks were virtually worthless. Overall, WorldCom's accounting fraud amounted to approximately \$11 billion.

Discovery of WorldCom's fraud led to investigations by the Department of Justice, the Securities and Exchange Commission (SEC), several states, Canada, and Mexico. Investigators also investigated a \$400 million loan that WorldCom's board of directors made to Ebbers. Although Ebbers was not initially charged, it soon became evident that he had been aware of the fraudulent accounting practices all along.

Ebbers and former CEO Scott Sullivan were charged on 15 counts by both federal prosecutors and prosecutors in Oklahoma and New York. The charges included lying to investors about WorldCom's worth. If convicted of the charges, Ebbers

and Sullivan could each face at least ten years in jail and fines of up to \$10 million on each charge. Former WorldCom employees David Myers, Bedford Yates, Betty Vinson, and Troy Nomand all pleaded guilty to charges of fraud and agreed to cooperate with prosecutors. Prosecutors in Oklahoma charged WorldCom/MCI with 15 violations of the Oklahoma Securities Law on charges that the company's bankruptcy cheated investors out of millions of dollars. The state lost at least \$64 million in state-pension funds that were invested in WorldCom stocks. WorldCom filed for bankruptcy in July 2002, creating chaos among its investors and playing havoc with the American economy. In October 2003, a federal judge approved a redesigned settlement of \$750 million. The settlement included a civil penalty of \$2.25 billion to be paid by an initial payment of \$500 million in cash and \$250 million in common stock to shareholders and bondholders to be distributed after WorldCom emerged from the Chapter 11 bankruptcy proceedings. Trade creditors were set to receive 52.7 cents on a dollar rather than the 36 cents on a dollar originally negotiated.

Microwave Communications Incorporation (MCI) took over WorldCom on October 1, 1997, although WorldCom continued to operate under its own name. In an effort to avoid being associated with the negative publicity that followed the WorldCom scandal, WorldCom officially became known as MCI.

Congress passed the Sarbanes-Oxley Act in July 2003 in response to various accounting scandals over a period of years. The law required all busi-

nesses to include internal controls, ethics codes, and information about audit committees in annual reports. While Congress intended to prevent unethical conduct, many businesses claimed that it was difficult to comply with all the regulations of Sarbanes-Oxley. As proof of its own intention to comply with the new law, MCI promised that it would heed the recommendations of a former chairman of the SEC who was assigned to monitor the company. The company emerged from bankruptcy in 2004.

#### SEE ALSO

accounting fraud; stock fraud; consequences of white-collar crime; reform and regulation.

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# Appendix A

## Resource Guide

Selected sources for more information; please see article bibliographies for complete references.

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- Environmental Crime: The Criminal Justice System's Role in Protecting the Environment* by Yingyi Situ and David Emmons (Sage Publications, 2000)
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- Impact of Public Policy on Corporate Offenders, The* by Brent Fisse and John Braithwaite (State University of New York Press, 1983)
- In the Wake of the Exxon Valdez* by Art Davidson (Sierra Club Books, 1990)
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- Informed Consent* by John A. Byrne (McGraw-Hill, 1996)
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- Law and Insider Trading: In Search of A Level Playing Field* by Elizabeth Szockyj (William S. Hein & Co., 1993)
- Masters of Deception: The Worldwide White-Collar Crime Crisis and Ways to Protect Yourself* by Louis Mizell (Wiley, 1997)
- Medical Malpractice: Theory, Evidence, and Public Policy* by Patricia M. Danzon (Cambridge University Press, 1985)
- Merchants of Death: The American Tobacco Industry* by Lawrence White (Beech Tree, 1988)
- Occupational Fraud and Abuse* by Joseph T. Wells (Obsidian Publishing, 1997)
- On White-Collar Crime* by Gilbert Geis (D.C. Heath, 1982)
- Organization of Corporate Crime: Dynamics of Antitrust Violation* by Katherine M. Jamieson (Sage Publications, 1994)
- Organized Crime* by Gary W. Potter and Michael D. Lyman (Prentice Hall, 2002)
- Organized Crime: A Compilation of U.N. Documents 1975–1998* by M. Cherif Bassiouni and Eduardo Vetere (Transnational Publishers, 1998)
- Organizing the Breathless: Cotton Dust, Southern Politics, & the Brown Lung Association* by Robert E. Botsch (University Press of Kentucky, 1993)
- Other People's Money* by Donald R. Cressey (Free Press, 1953)
- Outrageous Misconduct: The Asbestos Industry on Trial* by Paul Bradeur (Pantheon Books, 1985)
- Prescription for Profit: How Doctors Defraud Medicaid* by Paul Jesilow, Henry Pontell, and Gilbert Geis (University of California Press, 1993)
- Profit Without Honor: White Collar Crime & the Looting of America* by Stephen M. Rosoff, Robert Tillman, and Henry Pontell (Prentice Hall, 2001)
- Regulating Fraud: White-Collar Crime and the Criminal Process* by M. Levi (Tavistock, 1987)
- Restorative Justice and Responsive Regulation* by John Braithwaite (Oxford University Press, 2002)

- Road to Love Canal: Managing Industrial Waste before EPA* by Craig E. Colten and Peter Skinner (University of Texas Press, 1996)
- Silent Spring* by Rachel Carson (Houghton Mifflin, 1962)
- Sin and Society: An Analysis of Latter-Day Inequity* by E.A. Ross (Houghton Mifflin, 1965)
- Sitting in Judgment: The Sentencing of White-Collar Criminals* by Stanton Wheeler, Kenneth Mann, and Austin Sarat (Yale University Press, 1988)
- Stealing Dreams: A Fertility Clinic Scandal* by Gilbert Geis (Northeastern University Press, 2004)
- Swindled! Classic Business Frauds of the Seventies* by Donald Moffitt (Dow Jones Books, 1976)
- The Jungle* by Upton Sinclair (Bantam Classics, reprint 1981)
- Theft of the Nation: The Structure and Operations of Organized Crime in America* by Donald R. Cressey (Harper and Row, 1969)
- To Punish or Persuade: Enforcement of Coal Mine Safety* by John Braithwaite (State University of New York Press, 1985)
- Tony Soprano's America: The Criminal Side of the American Dream* by David R. Simon (Westview, 2002)
- Trusted Criminals: White Collar Crime in Contemporary Society* by David O. Friedrichs (Wadsworth Publishing Company, 2004)
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- Unsafe at Any Speed: The Designed-In Dangers of the American Automobile* by Ralph Nader (Grossman, 1972)
- Utilization-Focused Evaluation: The New Century Text* by Michael Quinn Patton (Sage Publications, 1997)
- Wall Street Words: An Essential A to Z Guide for Today's Investor* by David L. Scott (Houghton Mifflin, 1997)
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- Wealth by Stealth: Corporate Crime, Corporate Law and the Perversion of Democracy* by Harry Glasbeck (Between the Lines, 2002)
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- White Collar Crime Reconsidered* edited by K. Schlegel and D. Weisburd (Northeastern University Press, 1992)
- White Collar Crime: Cases and Materials* by Pamela H. Bucy (West Publishing, 1992)
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- White-Collar Crime* by Edwin H. Sutherland (Holt, Rinehart, and Winston, 1949)
- White-Collar Crime in a Nutshell* by Ellen S. Podgor and Jerold H. Israel (West Publishing, 1997)
- White-Collar Crime in America* by Jay Albanese (Prentice Hall, 1994)
- White-Collar Crime: Classic and Contemporary Views* edited by Gilbert Geis, Robert F. Meier, and Lawrence M. Salinger (Free Press, 1995)
- White-Collar Crime: The Uncut Version* by Edwin H. Sutherland (Yale University Press, 1983)
- White-Collar Deviance* by David R. Simon and Frank E. Hagan (Allyn & Bacon, 1998)
- Women Who Embezzle or Defraud: A Study of Convicted Felons* by Dorothy Zeitz (Praeger, 1981)
- Journals**
- Advances in Criminological Theory* (Rutgers University Press)
- American Criminal Law Review* (Georgetown University Press)
- American Journal of Criminal Law* (University of Texas Press)
- American Journal of Sociology* (University of Chicago Press)
- American Sociological Review* (American Sociological Association)
- Corporate Counsel's Guide to White-Collar Crime* (Business Laws, Inc.)
- Criminal Justice* (Sage Publications)
- Criminology* (American Society of Criminology)
- Environmental Law Reporter* (Environmental Law Institute)
- FBI Law Enforcement Bulletin* (Federal Bureau of Investigation)
- FDA Consumer* (Food and Drug Administration)
- Harvard Journal of Law and Public Policy* (Harvard University)
- Journal of Business Ethics* (Kluwer Academic Publishers)
- Journal of Contemporary Criminal Justice* (Sage Publications)



*Journal of Criminal Law and Criminology*  
(Northwestern University School of Law)  
*Journal of Financial Economics*  
(University of Rochester Press)  
*Justice Quarterly*  
(Academy of Criminal Justice Sciences)  
*Law and Society Review*  
(Law and Society Association)  
*Management Review*  
(Massachusetts Institute of Technology Press)  
*Social Problems*  
(Society for the Study of Social Problems)  
*The British Journal of Criminology*  
(Oxford University Press)  
*Theoretical Criminology*  
(Sage Publications)  
*Western Criminology Review*  
(Western Society of Criminology)  
*International Journal of Social Economics*  
(Emerald Academic)  
*International Journal of the Economics of Business*  
(Routledge, Taylor & Francis)

### Magazine and Newspapers

*Advertising Age* (Crain Communications)  
*Adweek* (VNU Business Publications)  
*American Demographics* (Primedia Publishing)  
*Black Enterprise* (Earl G. Graves, Ltd.)  
*Bloomberg Markets* (Bloomberg LP)  
*Business 2.0* (Business 2.0 Media, Inc.)  
*BusinessWeek* (McGraw-Hill Companies, Inc.)  
*Corporate Crime Reporter*  
(American Communications)  
*Crain's Chicago Business* (Crain Communications)  
*Crain's New York Business* (Crain Communications)  
*Euromoney* (Euromoney Institutional Investor PLC)  
*Far Eastern Economic Review*  
(Dow Jones & Company, Inc., Hong Kong)  
*Fast Company* (Gruner + Jahr USA Publishing)  
*Financial Times* (The Financial Times, Ltd.)  
*Forbes* (Forbes, Inc.)  
*Fortune* (Time, Inc.)  
*Harvard Business Review* (Harvard University Press)  
*Inc.* (Gruner + Jahr USA Publishing)  
*Industry Week* (Penton Media, Inc.)  
*International Herald Tribune*  
(The New York Times Company)  
*Investor's Business Daily* (Investors' Business Daily)  
*Kiplinger's* (The Kiplinger Washington Editors)

*New York Times*  
(The New York Times Company)  
*Money* (Time Inc., Time Warner)  
*Smart Money* (Dow Jones & Company)  
*The Economist* (The Economist Group, Inc.)  
*Wall Street Journal*  
(Dow Jones & Company, Inc.)  
*Washington Post*  
(The Washington Post Company)  
*White-Collar Crime Fighter*  
(White Collar Crime 101 LLC)  
*White-Collar Crime Reporter* (Andrews Publications)  
*Worth* (Worth Media)

### Internet Websites

Almost all journals, magazines, newspapers, and associations have dedicated websites that can be easily located using standard internet search engines. One rule of caution in using internet research tools in white-collar and corporate crime: rely on "branded" media, that is, websites associated with known media and institutions. Some recommended websites include:

[www.bbb.org](http://www.bbb.org) (Better Business Bureau)  
[www.commerce.gov](http://www.commerce.gov)  
(U.S. Department of Commerce)  
[www.cpsc.gov](http://www.cpsc.gov)  
(Consumer Product Safety Commission)  
[www.epa.gov](http://www.epa.gov)  
(U.S. Environmental Protection Agency)  
[www.fda.gov](http://www.fda.gov)  
(U.S. Food and Drug Administration)  
[www.hoovers.com](http://www.hoovers.com)  
(Hoover's Handbook of American Business)  
[www.loc.gov](http://www.loc.gov) (U.S. Library of Congress)  
[www.nber.org](http://www.nber.org)  
(National Bureau of Economic Research)  
[www.nw3c.org](http://www.nw3c.org)  
(National White-Collar Crime Center)  
[www.sec.gov](http://www.sec.gov)  
(U.S. Securities and Exchange Commission)  
[www.un.org/english](http://www.un.org/english) (United Nations)  
[www.doj.gov](http://www.doj.gov) (U.S. Department of Justice)  
[www.treas.gov](http://www.treas.gov) (U.S. Treasury Department)  
[www.whitehouse.gov/omb/budget/fy2004/](http://www.whitehouse.gov/omb/budget/fy2004/)  
(Budget of the United States)  
[www.whitecollarcrimefyi.com](http://www.whitecollarcrimefyi.com)  
(Lawyershop, Inc.)



# Appendix B

## Glossary

Italics refer to cross-referenced Glossary entries.

**Abuse:** In some cultures, a minor *Fraud* or infraction.

**Accomplice:** In fraud, a partner to the fraud scheme. See also *Perpetrator* and *Shill*.

**Advance Fee Scheme:** The *Fraudster* collects fees in advance without ever intending to fulfill the agreement to provide services or products.

**Affidavit:** A sworn statement.

**Affiliate Bidding:** A condition in purchasing when multiple bids are tendered for a contract from a single company under various names to give the appearance of competition.

**Agent:** A person with an agency relationship (employee or independent contractor).

**At will:** An employment situation where the employee is not protected from arbitrary firing — the employee works only at the pleasure of management and may be terminated at any time for no reason. Contrast *For cause*.

**Backdate:** To post a date on a document earlier than the actual creation date for purposes of deception.

**Back Door:** In computer fraud, unauthorized entry point or weakness discovered by a *Hacker*. Similar to *Trapdoor*, except that back doors are usually pre-existing weaknesses.

**Bait-and-Switch:** In consumer fraud, advertising a low cost item and then steering customers to a

higher-priced item when they come to buy, claiming the low priced item was sold out.

**Bank Examiner Scheme:** The *Fraudster* poses as a bank examiner who is trying to catch a dishonest teller. The bank examiner needs the victim to withdraw a substantial sum from her account to test the teller. The examiner then asks the victim to hand over the cash for a receipt while he uses the cash as evidence. The fraudulent examiner then disappears with the cash, and the receipt turns out to be worthless.

**Bankruptcy Fraud:** The *Perpetrator* files a notice of bankruptcy. He then approaches each of his creditors (who have received a copy of the notice of bankruptcy) and tells each one in turn that they are the special one that he wants to see get paid at least something. The creditor often settles for 10 percent of the amount owed. Once a settlement with one creditor is reached, the perpetrator approaches the next creditor, and so on until all creditors have been settled at a small fraction of the outstanding amounts owed. The perpetrator then withdraws his petition for bankruptcy, have extinguished most of his debt for a small fraction of the original amount.

**Bid Rigging:** In purchasing, any scheme that gives the appearance of competitive bids but is actually not competitive because the participants establish the winner before submitting bids for the contract. See *Affiliate Bidding* and *Bid Rotation*.

**Bid Rotation:** In purchasing, when bidders for contracts *Collude* to distribute work among themselves by establishing which among them will win particular bids.

**Boiler Room Operation:** A fraud scheme that attempts to sell worthless securities (or similar assets) over the telephone through high pressure sales tactics. If the money is sent in or the credit card number given out, there is nothing of value received.

**Bribery:** To offer money in exchange for favorite treatment or to compel or influence some action. Official (government employee or elected official) bribery involves a promise for acting or withholding some official act. Official bribery (*Corruption*) is unlawful in most cultures. *Commercial Bribery* is known as “facilitating payments” in some cultures and is not a crime in most cultures, although it often is against the organization’s policies and procedures.

**Bucket Shop:** A securities fraud scheme that pretends to buy and sell securities for customers, but actually never invests the money it receives. The scheme depends upon stock price manipulation or a continuously rising market to encourage more buyers than sellers. Also associated sometimes with the *Pump-and-Dump* scheme.

**Case Method:** In fraud *Investigation*, a six-step process of gathering evidence in order to identify a *Suspect*.

**Chain of Custody:** In evidentiary matters, the record of possession from original discovery until produced at trial. If the chain of custody is broken or unclear, the *Evidence* may be challenged as not the original or not in its original condition.

**Chain Letter Schemes:** Letters with names listed and claims that the recipient of the letter, by putting their name on the list, removing the top name and sending them some nominal amount, then mailing the new list to some number of friends and acquaintances, will receive a lot of riches in the mail. There is usually also a “curse” or bad luck associated with individuals who “break the chain.”

**Check Kiting:** See *Kiting*.

**Code of Ethics:** A document adopted by an organization that describes the expectations of the organization of employee and management behavior to all employees, suppliers, customers, the government, and the community.

**Coerce:** To influence action against someone’s will, usually by threat.

**Collateral Frauds:** Fraudulent representing collat-

eral for loans that 1) does not exist, 2) is not owned by the loan applicant, or 3) is grossly over-valued, or all of these.

**Collude:** In the context of *Fraud*, to act together for a fraudulent purpose.

**Commercial Bribery:** Giving and accepting payments to favor or not favor a commercial transaction or relationship. See also *Bribery* and *Corruption*.

**Computer Virus:** See *Virus*.

**Con:** Short form of *Confidence Game*.

**Conceal(ment):** The second step in committing a *Fraud*. To hide from view.

**Confidence Game:** A fraud scheme where the *Perpetrator* gains the confidence of the *Mark* to defraud the *Mark* in some way. Perfect confidence games are so effective that Marks do not report them to the authorities for fear of looking foolish or because the game involved something unlawful (such as illegal gambling).

**Conflict of Interest:** An employee owes a duty to the employer to act in the interest of the employer (and no other) when carrying out the duties of an employer. A conflict exists when the employee has some personal kinship, friendship or financial interest in the transaction that may divide the employee’s interests and put his duty to his employer in jeopardy.

**Conspiracy:** Two or more persons come together for the purpose of committing a *Fraud*.

**Conversion:** The third step in a *Fraud*. To exchange for personal gain.

**“Cooking the Books”:** Altering the official accounts to deceive. See also *Journal Entry Fraud*.

**Corruption:** *Bribery* of a government official. See also *Commercial Bribery*.

**Cost of Goods Sold changes:** Unusual changes in cost of goods sold as a percentage of sales may be an indicator of the theft of revenue or theft of finished goods inventory. See *Fictitious Refunds Fraud*.

**Covert:** Hidden or secret, as in *Covert Operations*.

**Covert Operation:** A plan or activity to obtain evidence through *Operatives* or *Agents* whose true role is undisclosed to the target. Examples of covert operations include *Undercover* work and *Pretense*. See also *Ruse*.

**Cyber-crime:** Referring to frauds perpetrated on the Internet or through the use of computers.

**Cycle Counts:** In inventory control, counting various portions of the inventory frequently until it is all counted (vs. counting once a quarter or year).

**Defalcation:** A word for *Fraud*, theft, or other dis-

honest act relating to a position of trust in an organization.

**Defamation:** The act of knowingly uttering *Slander* or printing *Libel* that is untrue but harms another person's character and reputation.

**Denial of Access attack:** A computer *Virus* or computer program run to generate many thousands of requests to the central computer, thereby tying up the processor and denying legitimate requests of access.

**Deposition:** A pre-trial legal proceeding in which a person is questioned under oath by an attorney, usually witnessed and recorded by audio, video, and/or written verbatim notes. The purpose of the deposition is to discover *Evidence* that may be used later at trial or to induce the person to make statements of fact that can be used at trial.

**Directory Advertising Schemes:** Fraudulent invoices claiming that the company is listed in a business directory and requesting payment. There may or may not be such a directory, and the directory may or may not ever be distributed or distributed as widely as claimed. For certain, no one ever ordered or authorized the directory advertisement. See also *Shipping Short*.

**Documentary Evidence:** Written or photographic representations of fact.

**Dual Custody:** A method of protecting cash by requiring all cash assets handled by two people (two signatures, two keys, two people counting, etc.).

**Dummy:** Fictitious.

**"Dumpster Diving":** Rummaging through someone's trash to obtain information.

**Electronic Surveillance:** Listening and/or recording activities using electronic means (audio and video) without being detected. In some jurisdictions, electronic surveillance is unlawful without permission from all parties.

**Embezzlement:** Theft of money from an employer by an employee using false entries in accounting records to cover up the crime. See also *Journal Entry Fraud*.

**Employee Account Fraud:** When employees are also customers, employees may make unauthorized adjustments to their accounts (including write-off).

**Entrapment:** Unlawfully lured into a crime by a police officer. A common defense in a criminal activity where the criminal claims they were innocent and would not have been involved in the crime otherwise.

**Expense Report Fraud:** Charging unauthorized or

fictitious amounts on an expense report. See *Padding Expense Accounts*.

**Exposure:** The potential for loss.

**Extortion:** The offer to keep from harm in exchange for money or other consideration. The demand for *Restitution* in exchange for not prosecuting a crime is a form of extortion.

**Factors of Fraud:** Opportunity (an opening or control weakness to be able to commit the fraud), Pressure (a problem that cannot be shared or resolved), and Attitude (a propensity to steal or the ability to rationalize fraudulent behavior). All frauds have these three factors as a cause.

**False Claims:** Claims for reimbursement by an employee or contractor for nonexistent or inflated expenses. False claims can be for business expenses or personal expenses (such as medical). See *Padding Expense Accounts*.

**False Credentials:** Misrepresenting education or experience or professional certification to fraudulently obtain and hold employment.

**False Imprisonment:** During an *Interrogation*, blocking the subject's avenue of escape, essentially holding the person against their will. Unless the person has been arrested, they may not be detained against their will at any time.

**False Pretense:** See *Pretense*, *Ruse* or *Subterfuge*.

**Fictitious Refunds Scheme:** Preparing false documents of refunds to cover thefts of cash. A retail cashing fraud. See *Cost of Goods Sold changes*.

**Fictitious Sales:** A scheme to record sales to fictitious customers or fictitious sales to existing customers at the end of one period and reversing the transactions at the beginning of the next period. The purpose of the scheme is to inflate sales to create false profit statements or earn unwarranted bonuses. Excessive credit memos or sales cancellations at the beginning of an accounting period can be an indicator of this fraud.

**Fiduciary Duty:** The acts necessary (usually of an authorized employee or agent) to carry out a responsibility to care for assets prudently. See *Embezzlement*.

**Firewall:** A software program that protects direct access to a local area network by establishing a public network in front of the trusted network. The purpose of the program is to secure data and systems from *Hackers*.

**For Cause:** An employment arrangement where employees may only be terminated for a proven cause. For contrast, see *At will*.

**Forensic:** Suitable for use in a court proceeding.

**Forensic Auditing:** Examination of a business process for evidence of *Fraud*.

**Forgery:** Creation of false documents or altering existing documents, especially financial instruments or other authorizations.

**Fraud:** A theft, concealment and conversion to personal gain of another's money, physical assets, information, or time.

**Fraud Scenarios:** A method of developing mental models of possible *Frauds*.

**Fraudster:** One who commits the *Fraud*.

**Ghost Employees:** Fictitious employees on the payroll, for whom the supervisor or manager receives the extra paychecks.

**Hacker:** (Old) One who enjoys unraveling the mysteries of the computer. (Modern) A person who attacks another's computer and seeks to gain unauthorized access by hacking (breaking down) the computer's logical security.

**Hearsay:** A weak form of evidence that is an opinion of the witness or that is not personally and directly known to her.

**Hidden Bank Accounts:** A possible indication of *Embezzlement*, *Bribery* or *Kickback* frauds.

**Hot Line:** A telephone number to report suspected *Fraud*. Often hot lines are handled as anonymous tips.

**Impeach:** In *Testimony*, to catch the person in a lie or contradiction of fact.

**Improprieties:** A polite word for *Frauds* and wrongdoings.

**Inflated Inventory:** An indication of *Embezzlement* or possible theft of inventory. See *Inventory Shrinkage*.

**Influence Peddling:** The offer by a government official to use their office to influence actions for a private party in return for something of value.

**Informant:** A person, such as a co-worker or friend of the accused, used in the investigation of a fraud who may know something about the crime but is otherwise not involved.

**Insider Trading:** Using business information not released to the public to reap profits trading in the financial markets.

**Interrogation:** An interview of a suspect conducted for the main purpose of obtaining an admission of guilt, to identify and neutralize defenses the target may raise, and to obtain information used to impeach the *Suspect*.

**Interview:** A structured (planned) question and an-

swer session with a person designed to elicit information.

**Inventory Shrinkage:** Theft of physical inventory.

**Investigation:** A structured gathering of *Documentary Evidence* and *Testimony* to solve a reported *Fraud*.

**Irregularity:** A polite word for *Fraud*.

**Journal Entry Fraud:** Using accounting journal entries to fraudulently adjust financial statements. See also *Embezzlement*.

**Kickback:** A payment by a vendor to an employee at the request of the employee in order for the vendor to receive favorable treatment.

**Kiting:** Using several bank accounts in different banks, making deposits and writing checks against the accounts before the deposit checks clear the banking system, creating a "float" of money out of nothing more than the lag in time while checks clear and post to their respective accounts.

**Lapping:** Stealing a customer payment and then using a subsequent customer payment to cover the previous customer's account. This overlapping payments creates a "float" of money that can be used as long as all payments are eventually posted. What usually occurs is that the lapping process builds up like a giant pyramid until it falls apart when not enough payments are available to cover the amounts owed.

**Libel:** Knowingly publishing false statements about another person that creates harm.

**Lie Detector:** See *Polygraph*.

**Lifestyle changes:** A possible indicator of theft is the sudden change in lifestyle such as exhibiting more than usual wealth.

**Lowballing:** Placing an unusually low bid to win the business. Often with the intent to inflate the price later with extras or change orders. Also can indicate a defective *Request for Proposal*.

**Malicious Prosecution:** Targeting someone for prosecution without reasonable grounds for suspicion.

**Mark:** The intended victim of a *Swindle* or *Confidence Game*.

**Misappropriation:** A polite word for theft.

**Multi-Level Marketing:** A form of *Pyramid Scheme*, not necessarily fraudulent, where sales are made to retail customers and commissions earned through many levels of the chain within the pyramid. The chain is built and expanded by each layer constantly recruiting more people to sell the product.

**Negative Invoicing:** Using an invoice for a negative

amount to cover a theft of a customer payment. The negative invoice is less noticeable than a credit memorandum and usually under less stringent control. A negative invoice is a symptom of possible theft.

**Nigerian Letter:** A fraud scheme that now includes fax and email versions of a letter from a supposed official in Nigeria. The official has a large sum of money (often stated as \$20 to \$30 million) to transfer out of the country. Due to exchange controls, the official asks for the victim's help with the transfer. All that is required to earn a hefty reward/commission is to furnish the Nigerian official with your bank account number, and they will handle the rest. What actually happens is that the *Perpetrator* depletes the victim's account.

**Obstruction of Justice:** Impeding a lawful investigation by such acts as providing false documents, false testimony, destruction of evidence, and intimidating witnesses.

**Ombudsman:** A person who acts as an advocate for employee grievances against the organization. Also, a neutral party to whom employees can turn to report *Fraud*.

**Operative:** A person acting on one's behalf or under care, custody or control in a specific manner. A source or *Informant* working *Undercover* in *Covert Operations* is an operative. There is no agency relationship with an operative as with an *Agent*.

**Overbilling schemes:** Padding invoices with extraneous or fictitious items. Intentional duplicate billing, such as billing two parties for the same work is also an overbilling scheme.

**Overt:** Open, not hidden. See *Covert* for contrast.

**Out-of-Route:** Outside sales or service workers who deviate from their normal route or time schedule, such as conducting personal errands or taking excessively long coffee or lunch breaks.

**Outstanding Items:** In checking operations, checks that have been written but not cleared through the bank. An equivalent banking term for interbank transactions.

**Padding Expense Accounts:** Adding extra expense items or inflating the value of legitimate expense items to obtain unwarranted reimbursements.

**Padding Overtime:** Adding extra hours to falsely inflate the payroll and earn unwarranted pay.

**Palming:** To conceal in the hand.

**Perjury:** Lying under oath, including sworn court *Depositions*, *Affidavits*, statements, and documents.

**Perpetrator:** The person who commits the *Fraud*.

**Personal Identification Number:** A code used to access personal data or accounts.

**Pilfering:** *Theft*, usually referring to theft of physical goods. In retail business, customer theft is known as *Shoptlifting* and employee theft is called pilfering. Occasionally used also with theft of cash, especially petty cash or for small thefts.

**PIN:** See Personal Identification Number.

**Pigeon Drop:** A fraud scheme that involves a wallet/purse/envelope with a large sum of money in it but no identification. The *Perpetrator* and *Accomplice*, together with the victim "finds" the wallet, and the victim is persuaded to withdraw a sum of money as "good faith" to share in the cache. The victim is distracted and the *Perpetrators* steal the money and disappear with it.

**Pingponging:** In medical insurance or *Workers Compensation Fraud*, referring patients to other doctors in the same clinic in order to claim reimbursement for "consultations" rather than for actual treatment. See also *False Claims*.

**Polygraph:** A machine for recording a number of life signs (breathing rate, pulse, etc.) to aid in determining if a *Suspect* is lying. Also known as a *Lie Detector*.

**Ponzi Scheme:** A fraud in which a high rate of return is promised on investments. The first few investors receive the high rate of return from part of the investments of later victims. At no time is any actual investment made.

**Pretense:** Also *False Pretense*. To represent something to be what it is not. See *Ruse* and *Subterfuge*.

**Pump-and-Dump:** Manipulating stock prices by artificially creating demand through rumor, high pressure sales tactics, or multiple large orders. The price is pumped upwards and then when other investors join the trend, the original investors dump the stock in a rapid sell-off. See also *Bucket Shop*.

**Pyramid Scheme:** A commercial version of the *Chain Letter* scheme where the *Fraudster* sells bogus distributorships, franchises or business opportunity plans to people who are in turn induced to do the same. See also *Multi-Level Marketing*.

**Razoring:** Removing the last check, invoice, purchase order or other sequentially numbered item from a pad of items by carefully cutting with a razor around the staple holding the pad together. In this manner, fictitious transactions can be documented on official forms.

**Reconciliation:** A process of comparing details with control totals, such as checks paid during the

month and deposits made that month with the change in bank balance at end of the month.

**Red Flags:** Symptoms and indicators (of *Fraud*).

**Remote Access Unit:** See *Maintenance Port*.

**Request for Proposal:** A request to potential vendors for tender offers or bids to perform a service or provide a product (or both) to solve a particular business problem. See also *Request for Quote*.

**Request for Quote:** A request to potential vendors for price quotes and delivery terms, usually for much simpler procurement requirements than a *Request for Proposals*.

**Restitution:** Restoring money or property to the victim of a *Fraud*.

**Resume Inflation:** See *False Credentials*.

**Rube:** A slang term for a *Mark* or victim, especially someone who appears naïve.

**Ruse:** A scheme that tries to make something appear as something else. Hiding the true meaning or acting out a lie. A *Subterfuge* or *Pretense*.

**Sabotage:** Destroying or delaying some part of the business process.

**Salami:** In banking, a fraud that involves taking all of the round-down fractional cents from periodic interest payments and crediting them to a single account. Thus each transaction has only a thin slice removed.

**Salting cash:** Testing accounts receivable employee honesty by placing some cash in the customer receivables process to see if it is reported as cash or stolen.

**Secure Socket Layer:** A protocol used in electronic commerce to afford more security to transactions on the Internet.

**Self-Approval:** The act of authorizing a transaction for one's own benefits or gains, or an act of approval for an activity in which the approval authority participated.

**Sewer Service:** Many consumer frauds rely on litigation to win judgments to collect the proceeds of the fraud. These organizations limit the ability of the victim to defend against this litigation by not informing them of the suit (literally dropping the *Subpoena* "down the sewer") and filing false *Affidavits* in court that the litigation papers had been properly served.

**Shadowing:** Following the suspect or target of *Surveillance* from place to place to observe activities without being detected.

**Shell Game:** A game where a pebble or dried pea is hidden under one of three shells or cans. The *Perpe-*

*trator* moves the shells around quickly, often *Palm-ing* the pebble, and then asks the *Mark* to choose the shell where the pea is located. A common street *Confidence Game*. See also *Sleight-of-hand*.

**Shill:** A person in a *Confidence Game* who acts as a participant to draw in the *Mark*. An *Accomplice* — one who is paid to play as part of a *Swindle*. Derived from casino gambling, where the shill is a paid employee used to attract other gamblers.

**Shoplifting:** Customer theft from retail inventory. See also *Pilfering*.

**Short-and-Over:** An account used in cashiering operations to track the imbalance of cash to sales recorded. A perfectly balanced cash operation day-after-day, with no shorts or overs, is a symptom of possible theft. It is unusual to never make mistakes handling money.

**Shorting:** In medical frauds, delivering less prescription medicine than actually charged to the insurance company or government.

**Short Shipping:** Shipping less than the quantity shown on the invoice (or shipping nothing at all; see *Directory Advertising Scheme*).

**Shoulder Surfing:** Observing someone using a *PIN* (*Personal Identification Number*) by covertly looking over her shoulder, sometimes with the aid of binoculars or a video camera with zoom lens.

**Shrinkage:** See *Inventory Shrinkage*.

**Slander:** Knowingly uttering false statements about another person that causes harm.

**Sleight-of-hand:** A magician's trick. The ability to conceal a physical action by distracting the participant. See also *Palm-ing*.

**Spying:** See *Surveillance*.

**Stationary Surveillance:** Observation of activities of a suspect from one vantage point. Also known as a *Stakeout*.

**Statutory Employee:** An employee by action and tax law, but not actually on the payroll. There are potential violations of U.S. tax and employment benefits laws if independent contractors and consultants are found to be statutory employees instead.

**Suborn:** The act of *Bribery*.

**Subterfuge:** Masking the true nature or reason for an action.

**Surveillance:** Gathering evidence through observation from outside of the operation (contrasted with *Undercover*). Surveillance can be *Moving Surveillance*, *Stationary Surveillance* or *Electronic Surveillance*. Also known as *Spying*.

**Suspect (n.):** The target of the fraud Investigation. See also *Perpetrator* and *Fraudster*.

**Suspect (v.):** To place under suspicion of wrongdoing.

**Swindle:** A scheme to obtain money by *Ruse* or *False Pretense*. See also *Confidence Game*.

**Tailing:** See *Shadowing*.

**Testimony:** Oral evidence (representations of fact) taken by *Interview* or *Interrogation*. Testimonial evidence is necessarily weaker than *Documentary Evidence*.

**Theft:** The first step in a *Fraud*. Unlawfully taking.

**Thief's Calculator:** A collection of innocent-looking bits and pieces near the cash register for the purpose of tracking the amount of cash stolen by *Skimming*.

**Tone at the Top:** The messages and actions of senior management in relation to *Fraud* detection and deterrence.

**Trapdoor:** In computer fraud, a means of unauthorized access to the computer operating system or files, usually placed by a *Hacker*.

**Trojan Horse:** A type of computer program that remains inert (and possibly hidden) until activated by an external event such as a date. Used as *Viruses* to disrupt or destroy computer operations, or used to open a *Trapdoor* for unauthorized access.

**Unauthorized Use:** Policies should be in place to determine what business resources may be used for personal business and at what times. Other use constitutes *Theft*.

**Undercover:** Secret or *Covert Operations* where a person works under an assumed identity, adopts a disguise, or takes on an assumed role in order to

gather evidence for prosecution.

**Under-ring:** To record less than the actual sales price. Usually refers to a cashier ringing a sale on a cash register. Under-rings may be a method used in *Skimming* cash by the cashier, or they may be used to give unauthorized discounts to an *Accomplice*.

**Unethical:** Behavior that does not meet community standards for "right behavior," but that does not violate any laws either.

**Unlawful:** Behavior that violates established laws.

**Virus:** In computer operations, a program that is deliberately released to a system with the ability to replicate itself and spread by attaching unauthorized data to files. Viruses can be benign, just taking up disk storage space, or they may be vicious and actually destroy data or deny access.

**Voids:** In cashing, ringing a Void to cancel a previous sale. Excessive voids may be a sign of theft.

**Whistleblowing:** The act of an employee revealing suspected fraud (usually involving senior management) to an outside third party.

**Witnesses:** People who may have information of a *Fraud* based on observation.

**Worker's Compensation Fraud:** False claims for on-the-job injuries. Usually takes the *Collusion* of employee and unscrupulous doctors to submit false diagnoses. Back injuries (soft tissue strains) and stress are the most common ailments used in this scheme.

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# Appendix C

## Law Summaries

### Contents

Clayton Antitrust Act

Sherman Antitrust Act

Celler-Kefauver Act of 1950

Sarbanes-Oxley Act of 2002

Federal Food, Drug, and Cosmetic Act of 1914

False Claims Act

### Clayton Antitrust Act 1914

#### Title 15. Commerce and Trade

#### Chapter 1. Monopolies and Combinations in Restraint of Trade

##### § 12. Words defined; short title

(a) "Antitrust laws," as used herein, includes the Act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies," approved July second, eighteen hundred and ninety [15 USCS §§ 1 et seq.]; sections seventy-three to seventy-six, inclusive, of an Act entitled "An Act to reduce taxation, to provide revenue for the Government, and for other purposes," of August twenty-seventh, eighteen hundred and ninety-four [15 USCS §§ 8-11]; an Act entitled "An Act to amend sections seventy-three and seventy-six of the Act of August twenty-seventh, eighteen hundred and ninety-four, entitled 'An Act to reduce taxation, to provide revenue for the Government, and for other purposes,'" approved February twelfth, nineteen hundred and thirteen [amending 15 USCS §§ 8, 11]; and also this Act.

"Commerce," as used herein, means trade or commerce among the several States and with foreign nations, or between the District of Columbia or any Territory of the United States and any State, Territory, or foreign nation, or between any insular possessions or other places under the jurisdiction of the United States, or between any such possession or place and any State or Territory of the United States or the District of Columbia or any foreign nation, or within the District of Columbia or any Territory or any insular possession or other place under the jurisdiction of the United States: Provided, That nothing in this Act contained shall apply to the Philippine Islands.

The word "person" or "persons" wherever used in this Act shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

(b) This Act may be cited as the "Clayton Act."

##### § 13. Discrimination in price, services, or facilities

(a) Price; selection of customers. It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: Provided, That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: Provided, however, That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or classes of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: And provided further, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: And provided further, That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

(b) Burden of rebutting prima-facie case of discrimination. Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section,

and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: Provided, however, that nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

(c) Payment or acceptance of commission, brokerage or other compensation. It shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact for or in behalf, or is subject to the direct or indirect control, of any party to such transaction other than the person by whom such compensation is so granted or paid.

(d) Payment for services or facilities for processing or sale. It shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

(e) Furnishing services or facilities for processing, handling, etc. It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms.

(f) Knowingly inducing or receiving discriminatory price. It shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

§ 14. Sale, etc., on agreement not to use goods of competitor. It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

§ 15. Suits by persons injured

(a) Amount of recovery; prejudgment interest. Except as provided in subsection (b), any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. The court may award under this section, pursuant to a motion by such person promptly made, simple interest on actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only—

(1) whether such person or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in it as to show that such party or representative acted intentionally for

delay, or otherwise acted in bad faith;

(2) whether, in the course of the action involved, such person or the opposing party, or either party's representative, violated any applicable rule, statute, or court order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings; and

(3) whether such person or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof.

(b) Amount of damages payable to foreign states and instrumentalities of foreign states.

(1) Except as provided in paragraph (2), any person who is a foreign state may not recover under subsection (a) an amount in excess of the actual damages sustained by it and the cost of suit, including a reasonable attorney's fee.

(2) Paragraph (1) shall not apply to a foreign state if—

(A) such foreign state would be denied, under section 1605(a)(2) of title 28 of the United States Code [28 USCS § 1605(a)(2)], immunity in a case in which the action is based upon a commercial activity, or an act, that is the subject matter of its claim under this section;

(B) such foreign state waives all defenses based upon or arising out of its status as a foreign state, to any claims brought against it in the same action;

(C) such foreign state engages primarily in commercial activities; and

(D) such foreign state does not function, with respect to the commercial activity, or the act, that is the subject matter of its claim under this section as a procurement entity for itself or for another foreign state.

(c) Definitions. For purposes of this section—

(1) the term "commercial activity" shall have the meaning given it in section 1603(d) of title 28, United States Code [28 USCS § 1603(d)], and

(2) the term "foreign state" shall have the meaning given it in section 1603(a) of title 28, United States Code [28 USCS § 1603(a)].

§ 15a. Suits by United States; amount of recovery; prejudgment interest

Whenever the United States is hereafter injured in its business or property by reason of anything forbidden in the antitrust laws it may sue therefor in the United States district court for the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by it sustained and the cost of suit. The court may award under this section, pursuant to a motion by the United States promptly made, simple interest on threefold the damages for the period beginning on the date of service of the pleading of the United States setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only—

(1) whether the United States or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay or otherwise acted in bad faith;

(2) whether, in the course of the action involved, the United States or the opposing party, or either party's representative, violated any applicable rule, statute, or court order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings;

(3) whether the United States or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof; and

(4) whether the award of such interest is necessary to compensate the United States adequately for the injury sustained by the United States.

15b. Limitation of actions

Any action to enforce any cause of action under section 4, 4A, or 4C [15 USCS §§ 15, 15a, 15c] shall be forever barred unless commenced within four years after the cause of action accrued. No cause of action barred under existing law on the effective date of this Act shall be revived by this Act.

§ 16. Judgments

(a) Prima facie evidence; collateral estoppel. A final judgment or decree heretofore or hereafter rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws shall be prima facie evidence against such defendant in any action or proceeding brought by

any other party against such defendant under said laws as to all matters respecting which said judgment or decree would be an estoppel as between the parties thereto: Provided, That this section shall not apply to consent judgments or decrees entered before any testimony has been taken. Nothing contained in this section shall be construed to impose any limitation on the application of collateral estoppel, except that, in any action or proceeding brought under the antitrust laws, collateral estoppel effect shall not be given to any finding made by the Federal Trade Commission under the antitrust laws or under section 5 of the Federal Trade Commission Act [15 USCS § 45] which could give rise to a claim for relief under the antitrust laws.

(b) Consent judgments and competitive impact statements; publication in Federal Register; availability of copies to the public. Any proposal for a consent judgment submitted by the United States for entry in any civil proceeding brought by or on behalf of the United States under the antitrust laws shall be filed with the district court before which such proceeding is pending and published by the United States in the Federal Register at least 60 days prior to the effective date of such judgment. Any written comments relating to such proposal and any responses by the United States thereto, shall also be filed with such district court and published by the United States in the Federal Register within such sixty-day period. Copies of such proposal and any other materials and documents which the United States considered determinative in formulating such proposal, shall also be made available to the public at the district court and in such other districts as the court may subsequently direct. Simultaneously with the filing of such proposal, unless otherwise instructed by the court, the United States shall file with the district court, publish in the Federal Register, and thereafter furnish to any person upon request, a competitive impact statement which shall recite—

- (1) the nature and purpose of the proceeding;
- (2) a description of the practices or events giving rise to the alleged violation of the antitrust laws;
- (3) an explanation of the proposal for a consent judgment, including an explanation of any unusual circumstances giving rise to such proposal or any provision contained therein, relief to be obtained thereby, and the anticipated effects on competition of such relief;
- (4) the remedies available to potential private plaintiffs damaged by the alleged violation in the event that such proposal for the consent judgment is entered in such proceeding;
- (5) a description of the procedures available for modification of such proposal; and
- (6) a description and evaluation of alternatives to such proposal actually considered by the United States.

(c) Publication of summaries in newspapers. The United States shall also cause to be published, commencing at least 60 days prior to the effective date of the judgment described in subsection (b) of this section, for 7 days over a period of 2 weeks in newspapers of general circulation of the district in which the case has been filed, in the District of Columbia, and in such other districts as the court may direct—

- (i) a summary of the terms of the proposal for the consent judgment,
- (ii) a summary of the competitive impact statement filed under subsection (b),
- (iii) and a list of the materials and documents under subsection (b) which the United States shall make available for purposes of meaningful public comment, and the place where such materials and documents are available for public inspection.

(d) Consideration of public comments by Attorney General and publication of response. During the 60-day period as specified in subsection (b) of this section, and such additional time as the United States may request and the court may grant, the United States shall receive and consider any written comments relating to the proposal for the consent judgment submitted under subsection (b). The Attorney General or his designee shall establish procedures to carry out the provisions of this subsection, but such 60-day time period shall not be shortened except by order of the district court upon a showing that (1) extraordinary circumstances require such shortening and (2) such shortening is not adverse to the public interest. At the close of the period during which such comments may be received, the United States shall file with the district court and cause to be published in the Federal Register a response to such comments.

(e) Public interest determination. Before entering any consent judgment proposed by the United States under this section, the court shall determine that the entry of such judgment is in the public interest. For the

purpose of such determination, the court may consider—

(1) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or relief sought, anticipated effects of alternative remedies actually considered, and any other considerations bearing upon the adequacy of such judgment;

(2) the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

(f) Procedure for public interest determination. In making its determination under subsection (e), the court may—

(1) take testimony of Government officials or experts or such other expert witnesses, upon motion of any party or participant or upon its own motion, as the court may deem appropriate;

(2) appoint a special master and such outside consultants or expert witnesses as the court may deem appropriate; and request and obtain the views, evaluations, or advice of any individual, group or agency of government with respect to any aspects of the proposed judgment or the effect of such judgment, in such manner as the court deems appropriate;

(3) authorize full or limited participation in proceedings before the court by interested persons or agencies, including appearance amicus curiae, intervention as a party pursuant to the Federal Rules of Civil Procedure, examination of witnesses or documentary materials, or participation in any other manner and extent which serves the public interest as the court may deem appropriate;

(4) review any comments including any objections filed with the United States under subsection (d) concerning the proposed judgment and the responses of the United States to such comments and objections; and

(5) take such other action in the public interest as the court may deem appropriate.

(g) Filing of written or oral communications with the district court. Not later than 10 days following the date of the filing of any proposal for a consent judgment under subsection (b), each defendant shall file with the district court a description of any and all written or oral communications by or on behalf of such defendant, including any and all written or oral communications on behalf of such defendant, or other person, with any officer or employee of the United States concerning or relevant to such proposal, except that any such communications made by counsel of record alone with the Attorney General or the employees of the Department of Justice alone shall be excluded from the requirements of this subsection. Prior to the entry of any consent judgment pursuant to the antitrust laws, each defendant shall certify to the district court that the requirements of this subsection have been complied with and that such filing is a true and complete description of such communications known to the defendant or which the defendant reasonably should have known.

(h) Inadmissibility as evidence of proceedings before the district court and the competitive impact statement. Proceedings before the district court under subsections (e) and (f) of this section, and the competitive impact statement filed under subsection (b) of this section, shall not be admissible against any defendant in any action or proceeding brought by any other party against such defendant under the antitrust laws or by the United States under section 4A of this Act [15 USCS § 15a] nor constitute a basis for the introduction of the consent judgment as prima facie evidence against such defendant in any such action or proceeding.

(i) Suspension of limitations. Whenever any civil or criminal proceeding is instituted by the United States to prevent, restrain, or punish violations of any of the antitrust laws, but not including an action under section 4A [15 USCS § 15a], the running of the statute of limitations in respect of every private or State right of action arising under said laws and based in whole or in part on any matter complained of in said proceeding shall be suspended during the pendency thereof and for one year thereafter: Provided, however, That whenever the running of the statute of limitations in respect of a cause of action arising under section 4 or 4C [15 USCS §§ 15, 15c] is suspended hereunder, any action to enforce such cause of action shall be forever barred unless commenced either within the period of suspension or within four years after the cause of action accrued.

§ 17. Antitrust laws not applicable to labor organizations

The labor of a human being is not a commodity or article of com-

merce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

§ 18. Acquisition by one corporation of stock of another  
See Celler-Kefauver Act 1950

§ 19. Interlocking directorates and officers

(a) (1) No person shall, at the same time, serve as a director or officer in any two corporations (other than banks, banking associations, and trust companies) that are—

(A) engaged in whole or in part in commerce; and

(B) by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws;

if each of the corporations has capital, surplus, and undivided profits aggregating more than \$ 10,000,000 as adjusted pursuant to paragraph (5) of this subsection.

(2) Notwithstanding the provisions of paragraph (1), simultaneous service as a director or officer in any two corporations shall not be prohibited by this section if—

(A) the competitive sales of either corporation are less than \$ 1,000,000, as adjusted pursuant to paragraph (5) of this subsection;

(B) the competitive sales of either corporation are less than 2 per centum of that corporation's total sales; or

(C) the competitive sales of each corporation are less than 4 per centum of that corporation's total sales.

For purposes of this paragraph, "competitive sales" means the gross revenues for all products and services sold by one corporation in competition with the other, determined on the basis of annual gross revenues for such products and services in that corporation's last completed fiscal year. For the purposes of this paragraph, "total sales" means the gross revenues for all products and services sold by one corporation over that corporation's last completed fiscal year.

(3) The eligibility of a director or officer under the provisions of paragraph (1) shall be determined by the capital, surplus and undivided profits, exclusive of dividends declared but not paid to stockholders, of each corporation at the end of that corporation's last completed fiscal year.

(4) For purposes of this section, the term "officer" means an officer elected or chosen by the Board of Directors.

(5) For each fiscal year commencing after September 30, 1990, the \$ 10,000,000 and \$ 1,000,000 thresholds in this subsection shall be increased (or decreased) as of October 1 each year by an amount equal to the percentage increase (or decrease) in the gross national product, as determined by the Department of Commerce or its successor, for the year then ended over the level so established for the year ending September 30, 1989. As soon as practicable, but not later than January 31 of each year, the Federal Trade Commission shall publish the adjusted amounts required by this paragraph.

(b) When any person elected or chosen as a director or officer of any corporation subject to the provisions hereof is eligible at the time of his election or selection to act for such corporation in such capacity, his eligibility to act in such capacity shall not be affected by any of the provisions hereof by reason of any change in the capital, surplus and undivided profits, or affairs of such corporation from whatever cause, until the expiration of one year from the date on which the event causing ineligibility occurred.

§ 21. Enforcement provisions

(a) Commission, Board, or Secretary authorized to enforce compliance. Authority to enforce compliance with sections 2, 3, 7, and 8 of this Act [15 USCS §§ 13, 14, 18, 19] by the persons respectively subject thereto is hereby vested in the Surface Transportation Board where applicable to common carriers subject to jurisdiction under subtitle IV of title 49, United States Code [49 USCS §§ 10101 et seq.]; in the Federal Communications Commission where applicable to common carriers engaged in wire or radio communication or radio transmission of energy; in the Secretary of Transportation where applicable to air carriers and foreign air carriers subject to the Federal Aviation Act of 1958 [49 USCS §§ 40101 et seq.]; in the Federal Reserve Board [Board of Governors of the Federal Reserve System] where applicable to banks, banking associ-

ations, and trust companies; and in the Federal Trade Commission where applicable to all other character of commerce to be exercised as follows:

(b) Issuance of complaints for violations; hearing; intervention; filing of testimony; report; cease and desist orders; reopening and alteration of reports or orders. Whenever the Commission, Board, or Secretary vested with jurisdiction thereof shall have reason to believe that any person is violating or has violated any of the provisions of sections 2, 3, 7, and 8 of this Act [15 USCS §§ 13, 14, 18, 19], it shall issue and serve upon such person and the Attorney General a complaint stating its charges in that respect, and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the Commission, Board, or Secretary requiring such person to cease and desist from the violation of the law so charged in said complaint. The Attorney General shall have the right to intervene and appear in said proceeding and any person may make application, and upon good cause shown may be allowed by the Commission, Board, or Secretary, to intervene and appear in said proceeding by counsel or in person. The testimony in any such proceeding shall be reduced to writing and filed in the office of the Commission, Board, or Secretary. If upon such hearing the Commission, Board, or Secretary, as the case may be, shall be of the opinion that any of the provisions of said sections have been or are being violated, it shall make a report in writing, in which it shall state its findings as to the facts, and shall issue and cause to be served on such person an order requiring such person to cease and desist from such violations, and divest itself of the stock, or other share capital, or assets, held or rid itself of the directors chosen contrary to the provisions of sections 7 and 8 of this Act [15 USCS §§ 18, 19], if any there be, in the manner and within the time fixed by said order. Until the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time, or, if a petition for review has been filed within such time then until the record in the proceeding has been filed in a court of appeals of the United States, as hereinafter provided, the Commission, Board, or Secretary may at any time, upon such notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any report or any order made or issued by it under this section. After the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time, the Commission, Board, or Secretary may at any time, after notice and opportunity for hearing, reopen and alter, modify, or set aside, in whole or in part, any report or order made or issued by it under this section, whenever in the opinion of the Commission, Board, or Secretary conditions of fact or of law have so changed as to require such action or if the public interest shall so require: provided, however, That the said person may, within sixty days after service upon him or it of said report or order entered after such a reopening, obtain a review thereof in the appropriate court of appeals of the United States, in the manner provided in subsection (c) of this section.

(c) Review of orders; jurisdiction; filing of petition and record of proceeding; conclusiveness of findings; additional evidence; modification of findings; finality of judgment and decree. Any person required by such order of the commission, board, or Secretary to cease and desist from any such violation may obtain a review of such order in the court of appeals of the United States for any circuit within which such violation occurred or within which such person resides or carries on business, by filing in the court, within sixty days after the date of the service of such order, a written petition praying that the order of the commission, board, or Secretary be set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the commission, board, or Secretary and thereupon the commission, board, or Secretary shall file in the court the record in the proceeding, as provided in section 2112 of title 28, United States Code. Upon such filing of the petition the court shall have jurisdiction of the proceeding and of the question determined therein concurrently with the commission, board, or Secretary until the filing of the record, and shall have power to make and enter a decree affirming, modifying, or setting aside the order of the commission, board, or Secretary and enforcing the same to the extent that such order is affirmed, and to issue such writs as are ancillary to its jurisdiction or are necessary in its judgment to prevent injury to the public or to competitors pendente lite. The findings of the commission, board, or Secretary as to the facts, if supported by substantial ev-

idence, shall be conclusive. To the extent that the order of the commission, board, or Secretary is affirmed, the court shall issue its own order commanding obedience to the terms of such order of the commission, board, or Secretary. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the proceeding before the commission, board, or Secretary, the court may order such additional evidence to be taken before the commission, board, or Secretary, and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The commission, board, or Secretary may modify its findings as to the facts, or make new findings, by reason of the additional evidence so taken, and shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of its original order, with the return of such additional evidence. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, as provided in section 1254 of title 28 of the United States Code.

(d) Exclusive jurisdiction of Court of Appeals. Upon the filing of the record with it the jurisdiction of the court of appeals to affirm, enforce, modify, or set aside orders of the commission, board, or Secretary shall be exclusive.

(e) Liability under antitrust laws. No order of the commission, board, or Secretary or judgment of the court to enforce the same shall in anywise relieve or absolve any person from any liability under the antitrust laws.

(f) Service of complaints, orders and other processes. Complaints, orders, and other processes of the commission, board, or Secretary under this section may be served by anyone duly authorized by the commission, board, or Secretary, either (1) by delivering a copy thereof to the person to be served, or to a member of the partnership to be served, or to the president, secretary, or other executive officer or a director of the corporation to be served; or (2) by leaving a copy thereof at the residence or the principal office or place of business of such person; or (3) by mailing by registered or certified mail a copy thereof addressed to such person at his or its residence or principal office or place of business. The verified return by the person so serving said complaint, order, or other process setting forth the manner of said service shall be proof of the same, and the return post office receipt for said complaint, order, or other process mailed by registered or certified mail as aforesaid shall be proof of the service of the same.

(g) Finality of orders generally. Any order issued under subsection (b) shall become final—

(1) upon the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time; but the commission, board, or Secretary may thereafter modify or set aside its order to the extent provided in the last sentence of subsection (b); or

(2) upon the expiration of the time allowed for filing a petition for certiorari, if the order of the commission, board, or Secretary has been affirmed, or the petition for review has been dismissed by the court of appeals, and no petition for certiorari has been duly filed; or

(3) upon the denial of a petition for certiorari, if the order of the commission, board, or Secretary has been affirmed or the petition for review has been dismissed by the court of appeals; or

(4) upon the expiration of thirty days from the date of issuance of the mandate of the Supreme Court, if such Court directs that the order of the commission, board, or Secretary be affirmed or the petition for review be dismissed.

(h) Finality of orders modified by Supreme Court. If the Supreme Court directs that the order of the commission, board, or Secretary be modified or set aside, the order of the commission, board, or Secretary rendered in accordance with the mandate of the Supreme Court shall become final upon the expiration of thirty days from the time it was rendered, unless within such thirty days either party has instituted proceedings to have such order corrected to accord with the mandate, in which event the order of the commission, board, or Secretary shall become final when so corrected.

(i) Finality of orders modified by Court of Appeals. If the order of the commission, board, or Secretary is modified or set aside by the court of appeals, and if (1) the time allowed for filing a petition for certiorari has expired and no such petition has been duly filed, or (2) the petition for certiorari has been denied, or (3) the decision of the court has been

affirmed by the Supreme Court, then the order of the commission, board, or Secretary rendered in accordance with the mandate of the court of appeals shall become final on the expiration of thirty days from the time such order of the commission, board, or Secretary was rendered, unless within such thirty days either party has instituted proceedings to have such order corrected so that it will accord with the mandate, in which event the order of the commission, board, or Secretary shall become final when so corrected.

(j) Finality of orders issued on rehearing ordered by Court of Appeals or Supreme Court. If the Supreme Court orders a rehearing; or if the case is remanded by the court of appeals to the commission, board, or Secretary for a rehearing, and if (1) the time allowed for filing a petition for certiorari has expired, and no such petition has been duly filed, or (2) the petition for certiorari has been denied, or (3) the decision of the court has been affirmed by the Supreme Court, then the order of the commission, board, or Secretary rendered upon such rehearing shall become final in the same manner as though no prior order of the commission, board, or Secretary had been rendered.

(k) “Mandate” defined. As used in this section the term “mandate,” in case a mandate has been recalled prior to the expiration of thirty days from the date of issuance thereof, means the final mandate.

(l) Penalties. Any person who violates any order issued by the commission, board, or Secretary under subsection (b) after such order has become final, and while such order is in effect, shall forfeit and pay to the United States a civil penalty of not more than \$ 5,000 for each violation, which shall accrue to the United States and may be recovered in a civil action brought by the United States. Each separate violation of any such order shall be a separate offense, except that in the case of a violation through continuing failure or neglect to obey a final order of the commission, board, or Secretary each day of continuance of such failure or neglect shall be deemed a separate offense.

§ 22. District in which to sue corporation

Any suit, action, or proceeding under the antitrust laws against a corporation may be brought not only in the judicial district whereof it is an inhabitant, but also in any district wherein it may be found or transacts business; and all process in such cases may be served in the district of which it is an inhabitant, or wherever it may be found.

§ 23. Suits by United States; subpoenas for witnesses

In any suit, action, or proceeding brought by or on behalf of the United States subpoenas for witnesses who are required to attend a court of the United States in any judicial district in any case, civil or criminal, arising under the antitrust laws may run into any other district: Provided, That in civil cases no writ of subpoena shall issue for witnesses living out of the district in which the court is held at a greater distance than one hundred miles from the place of holding the same without the permission of the trial court being first had upon proper application and cause shown.

§ 24. Liability of directors and agents of corporation

Whenever a corporation shall violate any of the penal provisions of the antitrust laws, such violation shall be deemed to be also that of the individual directors, officers, or agents of such corporation who shall have authorized, ordered, or done any of the acts constituting in whole or in part such violation, and such violation shall be deemed a misdemeanor, and upon conviction therefor of any such director, officer, or agent he shall be punished by a fine of not exceeding \$ 5,000 or by imprisonment for not exceeding one year, or by both, in the discretion of the court.

§ 25. Restraining violations; procedure

The several district courts of the United States are invested with jurisdiction to prevent and restrain violations of this Act, and it shall be the duty of the several district attorneys of the United States [United States attorneys], in their respective districts, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition, the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition, and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises. Whenever it shall appear to the court before which any such proceeding may be pending that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned whether they reside in the district in which the

court is held or not, and subpoenas to that end may be served in any district by the marshal thereof.

§ 26. Injunctive relief for private parties; exception; costs

Any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws, including sections two, three, seven and eight of this Act [15 USCS §§ 13, 14, 18, and 19], when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity, under the rules governing such proceedings, and upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate, a preliminary injunction may issue: Provided, That nothing herein contained shall be construed to entitle any person, firm, corporation, or association, except the United States, to bring suit for injunctive relief against any common carrier subject to the jurisdiction of the Surface Transportation Board under subtitle IV of title 49, United States Code [49 USCS §§ 10101 et seq.]. In any action under this section in which the plaintiff substantially prevails, the court shall award the cost of suit, including a reasonable attorney's fee, to such plaintiff.

§ 27. Effect of partial invalidity

If any clause, sentence, paragraph, or part of this Act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder thereof, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

#### **Celler-Kefauver Act 1950 (amending § 7 of the Clayton Antitrust Act) Title 15. Commerce and Trade**

##### **Chapter 1. Monopolies and Combinations in Restraint of Trade**

§ 18. Acquisition by one corporation of stock of another

No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

No person shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce or in any activity affecting commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition.

Nor shall anything herein contained be construed to prohibit any common carrier subject to the laws to regulate commerce from aiding in the construction of branches or short lines so located as to become feeders to the main line of the company so aiding in such construction or from acquiring or owning all or any part of the stock of such branch lines, nor to prevent any such common carrier from acquiring and owning all or any part of the stock of a branch or short line constructed by an independent company where there is no substantial competition between the company owning the branch line so constructed and the company owning the main line acquiring the property or an interest therein, nor to prevent such common carrier from extending any of its lines

through the medium of the acquisition of stock or otherwise of any other common carrier where there is no substantial competition between the company extending its lines and the company whose stock, property, or an interest therein is so acquired.

Nothing contained in this section shall be held to affect or impair any right heretofore legally acquired: Provided, That nothing in this section shall be held or construed to authorize or make lawful anything heretofore prohibited or made illegal by the antitrust laws, nor to exempt any person from the penal provisions thereof or the civil remedies therein provided.

Nothing contained in this section shall apply to transactions duly consummated pursuant to authority given by the Secretary of Transportation, Federal Power Commission, Surface Transportation Board, the Securities and Exchange Commission in the exercise of its jurisdiction under section 10 of the Public Utility Holding Company Act of 1935 [15 USCS § 79j], the United States Maritime Commission, or the Secretary of Agriculture under any statutory provision vesting such power in such Commission, Board, or Secretary.

#### **Sherman Antitrust Act**

#### **United States Code Service**

#### **Title 15. Commerce and Trade**

##### **Chapter 1. Monopolies And Combinations In Restraint Of Trade**

§ 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$ 10,000,000 if a corporation, or, if any other person, \$ 350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 2. Monopolization; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$ 10,000,000 if a corporation, or, if any other person, \$ 350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 3. Trusts in Territories or District of Columbia illegal; combination a felony

(a) Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$ 10,000,000 if a corporation, or, if any other person, \$ 350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

(b) Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce in any Territory of the United States or of the District of Columbia, or between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia, and any State or States or foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$ 10,000,000 if a corporation, or, if any other person, \$ 350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 4 Jurisdiction of courts; duty of United States attorneys; Procedure The several circuit [district] courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this act [15 USCS §§ 1 et seq.]; and it shall be the duty of the several district attor-

neys of the United States [United States attorneys], in their respective districts, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

#### § 5. Bringing in additional parties

Whenever it shall appear to the court before which any proceeding under section four of this Act [15 USCS § 4] may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshal thereof.

#### § 6. Forfeiture of property in transit

Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this Act [15 USCS § 1], and being in the course of transportation from one State to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

§ 6a. Conduct involving trade or commerce with foreign nations This Act [15 USCS §§ 1 et seq.] shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless—

(1) such conduct has a direct, substantial, and reasonably foreseeable effect—

(A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or

(B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and

(2) such effect gives rise to a claim under the provisions of this Act [15 USCS §§ 1 et seq.], other than this section.

If this Act [15 USCS §§ 1 et seq.] applies to such conduct only because of the operation of paragraph (1)(B), then this Act [15 USCS §§ 1 et seq.] shall apply to such conduct only for injury to export business in the United States.

#### § 7. "Person" defined

The word "person," or "persons," wherever used in this Act [15 USCS §§ 1 et seq.] shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

### Sarbanes-Oxley Act 2002

#### United States Code Service

#### Title 15. Commerce and Trade

#### Chapter 98. Public Company Accounting Reform and Corporate Responsibility

#### § 7201. Definitions

In this Act, the following definitions shall apply:

(1) Appropriate State regulatory authority. The term "appropriate State regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(2) Audit. The term "audit" means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103 [15 USCS § 7213], in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.

(3) Audit committee. The term "audit committee" means—

(A) a committee (or equivalent body) established by and amongst

the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(4) Audit report. The term "audit report" means a document or other record—

(A) prepared following an audit performed for purposes of compliance by an issuer with the requirements of the securities laws; and

(B) in which a public accounting firm either—

(i) sets forth the opinion of that firm regarding a financial statement, report, or other document; or

(ii) asserts that no such opinion can be expressed.

(5) Board. The term "Board" means the Public Company Accounting Oversight Board established under section 101 [15 USCS § 7211].

(6) Commission. The term "Commission" means the Securities and Exchange Commission.

(7) Issuer. The term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

(8) Non-audit services. The term "non-audit services" means any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer.

(9) Person associated with a public accounting firm.

(A) In general. The terms "person associated with a public accounting firm" (or with a "registered public accounting firm") and "associated person of a public accounting firm" (or of a "registered public accounting firm") mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

(B) Exemption authority. The Board may, by rule, exempt persons engaged only in ministerial tasks from the definition in subparagraph (A), to the extent that the Board determines that any such exemption is consistent with the purposes of this Act, the public interest, or the protection of investors.

(10) Professional standards. The term "professional standards" means—

(A) accounting principles that are—

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933 [15 USCS § 77s(b)], as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s) [77s(a)]) [15 USCS § 77s(a)] or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m) [78m(b)] [15 USCS § 78m(b)]); and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a) [15 USCS § 7213(a)], or are promulgated as rules of the Commission.

(11) Public accounting firm. The term "public accounting firm" means—

(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and

(B) to the extent so designated by the rules of the Board, any associated person of any entity described in subparagraph (A).

(12) Registered public accounting firm. The term "registered public

accounting firm” means a public accounting firm registered with the Board in accordance with this Act.

(13) Rules of the Board. The term “rules of the Board” means the bylaws and rules of the Board (as submitted to, and approved, modified, or amended by the Commission, in accordance with section 107 [15 USCS § 7217]), and those stated policies, practices, and interpretations of the Board that the Commission, by rule, may deem to be rules of the Board, as necessary or appropriate in the public interest or for the protection of investors.

(14) Security. The term “security” has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(15) Securities laws. The term “securities laws” means the provisions of law referred to in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), as amended by this Act, and includes the rules, regulations, and orders issued by the Commission thereunder

(16) State. The term “State” means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

#### § 7202. Commission rules and enforcement

(a) Regulatory action. The Commission shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act.

(b) Enforcement.

(1) In general. A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.

(2)—(4) [Omitted]

(c) Effect on Commission authority. Nothing in this Act or the rules of the Board shall be construed to impair or limit—

(1) the authority of the Commission to regulate the accounting profession, accounting firms, or persons associated with such firms for purposes of enforcement of the securities laws;

(2) the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law; or

(3) the ability of the Commission to take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof.

#### Public Accounting Oversight Board

§ 7211. Establishment; administrative provisions

(a) Establishment of Board. There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a non-profit corporation, and have succession until dissolved by an Act of Congress.

(b) Status. The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a non-profit corporation by, the District of Columbia Nonprofit Corporation Act [unclassified]. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) Duties of the Board. The Board shall, subject to action by the Commission under section 107 [15 USCS § 7217], and once a determination is made by the Commission under subsection (d) of this section—

(1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102 [15 USCS § 7212];

(2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103 [15 USCS § 7213];

(3) conduct inspections of registered public accounting firms, in ac-

cordance with section 104 [15 USCS § 7214] and the rules of the Board;

(4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms, in accordance with section 105 [15 USCS § 7215];

(5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest;

(6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) Commission determination. The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act [enacted July 30, 2002], that the Board is so organized and has the capacity to carry out the requirements of this title [15 USCS §§ 7211 et seq.], and to enforce compliance with this title [15 USCS §§ 7211 et seq.] by registered public accounting firms and associated persons thereof. The Commission shall be responsible, prior to the appointment of the Board, for the planning for the establishment and administrative transition to the Board's operation.

(e) Board membership.

(1) Composition. The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) Limitation. Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) Full-time independent service. Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, subject to such conditions as the Commission may impose, under standard arrangements for the retirement of members of public accounting firms.

(4) Appointment of Board members.

(A) Initial board. Not later than 90 days after the date of enactment of this Act [enacted July 30, 2002], the Commission, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) Vacancies. A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) Term of service.

(A) In general. The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term.

(B) Term limitation. No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether



or not such terms of service are consecutive.

(6) Removal from office. A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3) [15 USCS § 7217(d)(3)], for good cause shown before the expiration of the term of that member.

(f) Powers of the Board. In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107 [15 USCS § 7217]—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;

(4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(5) to allocate, assess, and collect accounting support fees established pursuant to section 109 [15 USCS § 7219], for the Board, and other fees and charges imposed under this title [15 USCS §§ 7211 et seq.]; and

(6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title [15 USCS §§ 7211 et seq.].

(g) Rules of the Board. The rules of the Board shall, subject to the approval of the Commission—

(1) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;

(2) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board;

(3) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board; and

(4) provide as otherwise required by this Act.

(h) Annual report to the Commission. The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission.

#### § 7212. Registration with the Board

(a) Mandatory registration. Beginning 180 days after the date of the determination of the Commission under section 101(d) [15 USCS § 7211(d)], it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) Applications for registration.

(1) Form of application. A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) Contents of applications. Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year;

(B) the annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

(C) such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;

(D) a statement of the quality control policies of the firm for its accounting and auditing practices;

(E) a list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;

(F) information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;

(G) copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and

(H) such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.

(3) Consents. Each application for registration under this subsection shall include—

(A) a consent executed by the public accounting firm to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title [15 USCS §§ 7211 et seq.] (and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) Action on applications.

(1) Timing. The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) Treatment. A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c) [15 USCS §§ 7215(d), 7217(c)].

(d) Periodic reports. Each registered public accounting firm shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(e) Public availability. Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information.

(f) Registration and annual fees. The Board shall assess and collect a

registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

§ 7213. Auditing, quality control, and independence standards and rules

(a) Auditing, quality control, and ethics standards.

(1) In general. The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) Rule requirements. In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b) [15 USCS § 7262(b)], and present (in such report or in a separate report)—

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such internal control structure and procedures—

(aa) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(bb) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and

(III) a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.

(B) shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—

(i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;

(ii) consultation within such firm on accounting and auditing questions;

(iii) supervision of audit work;

(iv) hiring, professional development, advancement of personnel;

(v) the acceptance and continuation of engagements;

(vi) internal inspection; and

(vii) such other requirements as the Board may prescribe, subject to subsection (a)(1).

(3) Authority to adopt other standards.

(A) In general. In carrying out this subsection, the Board—

(i) may adopt as its rules, subject to the terms of section 107 [15 USCS § 7217], any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) Initial and transitional standards. The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional stan-

dards, to the extent the Board determines necessary, prior to a determination of the Commission under section 101(d) [15 USCS § 7211(d)], and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 [15 USCS § 7217] that otherwise would apply to the approval of rules of the Board.

(4) Advisory groups. The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) Independence standards and rules. The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) Cooperation with designated professional groups of accountants and advisory groups.

(1) In general. The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) and advisory groups convened under subsection (a)(4) in the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) Board responses. The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) Evaluation of standard setting process. The Board shall include in the annual report required by section 101(h) [15 USCS § 7211(h)] the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

§ 7214. Inspections of registered public accounting firms

(a) In general. The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) Inspection frequency.

(1) In general. Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) Adjustments to schedules. The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors. The Board may conduct special inspections at the request of the Commission or upon its own motion.

(c) Procedures. The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) Conduct of inspections. In conducting an inspection of a registered

public accounting firm under this section, the Board shall—

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) Record retention. The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 [15 USCS § 7213] or the rules issued thereunder.

(f) Procedures for review. The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) Report. A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be—

(1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm; and

(2) made available in appropriate detail to the public (subject to section 105(b)(5)(A) [15 USCS § 7215(b)(5)(A)], and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) Interim Commission review.

(1) Reviewable matters. A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response;

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) Treatment of review. Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be “final agency action” for purposes of section 704 of title 5, United States Code.

(3) Timing. Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

§ 7215. Investigations and disciplinary proceedings

(a) In general. The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

(b) Investigations.

(1) Authority. In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commis-

sion issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(2) Testimony and document production. In addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may—

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation under this section.

(3) Noncooperation with investigations.

(A) In general. If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) Procedure. Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c) [15 USCS § 7217(c)].

(4) Coordination and referral of investigations.

(A) Coordination. The Board shall notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate its work with the work of the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation.

(B) Referral. The Board may refer an investigation under this section—

(i) to the Commission;

(ii) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and

(iii) at the direction of the Commission, to—

(I) the Attorney General of the United States;

(II) the attorney general of 1 or more States; and

(III) the appropriate State regulatory authority.

(5) Use of documents.

(A) Confidentiality. Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 [15 USCS § 7214] or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) Availability to government agencies. Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) may—

(i) be made available to the Commission; and  
 (ii) in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, be made available to—

(I) the Attorney General of the United States;

(II) the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator;

(III) State attorneys general in connection with any criminal investigation; and

(IV) any appropriate State regulatory authority, each of which shall maintain such information as confidential and privileged.

(6) Immunity. Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) Disciplinary procedures.

(1) Notification; recordkeeping. The rules of the Board shall provide that in any proceeding by the Board to determine whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) bring specific charges with respect to the firm or associated person;

(B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) keep a record of the proceedings.

(2) Public hearings. Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) Supporting statement. A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and

(C) the sanction imposed, including a justification for that sanction.

(4) Sanctions. If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) temporary suspension or permanent revocation of registration under this title [15 USCS §§ 7211 et seq.];

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);

(D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than \$ 100,000 for a natural person or \$ 2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than \$ 750,000 for a natural person or \$ 15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(5) Intentional or other knowing conduct. The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct,

that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

(6) Failure to supervise.

(A) In general. The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—

(i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) Rule of construction. No associated person of a registered public accounting firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) Effect of suspension.

(A) Association with a public accounting firm. It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) Association with an issuer. It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) Reporting of sanctions.

(1) Recipients. If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) Contents. The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) Stay of sanctions.

(1) In general. Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) Expedited procedures. The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

§ 7216. Foreign public accounting firms

(a) Applicability to certain foreign firms.

(1) In general. Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 [15 USCS § 7212] shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) Board authority. The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm (or firms) for purposes of registration under, and oversight by the Board in accordance with, this title [15 USCS §§ 7211 et seq.].

(b) Production of audit workpapers.

(1) Consent by foreign firms. If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) Consent by domestic firms. A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) Exemption authority. The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) Definition. In this section, the term “foreign public accounting firm” means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof. § 7217. Commission oversight of the Board

(a) General oversight responsibility. The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. The provisions of section 17(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(a)(1)), and of section 17(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)(1)) shall apply to the Board as fully as if the Board were a “registered securities association” for purposes of those sections 17(a)(1) and 17(b)(1) [15 USCS § 78q(a)(1), (b)(1)].

(b) Rules of the Board.

(1) Definition. In this section, the term “proposed rule” means any proposed rule of the Board, and any modification of any such rule.

(2) Prior approval required. No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) [15 USCS § 7213(a)(3)(B)] with respect to initial or transitional standards.

(3) Approval criteria. The Commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) Proposed rule procedures. The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as

if the Board were a “registered securities association” for purposes of that section 19(b) [15 USCS § 78s(b)], except that, for purposes of this paragraph—

(A) the phrase “consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization” in section 19(b)(2) of that Act [15 USCS § 78s(b)(2)] shall be deemed to read “consistent with the requirements of title I of the Sarbanes-Oxley Act of 2002 [15 USCS §§ 7211 et seq.], and the rules and regulations issued thereunder applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors”; and

(B) the phrase “otherwise in furtherance of the purposes of this title” in section 19(b)(3)(C) of that Act [15 USCS § 78s(b)(3)(C)] shall be deemed to read “otherwise in furtherance of the purposes of title I of the Sarbanes-Oxley Act of 2002 [15 USCS §§ 7211 et seq.]”.

(5) Commission authority to amend rules of the Board. The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a “registered securities association” for purposes of that section 19(c) [15 USCS § 78s(c)], except that the phrase “to conform its rules to the requirements of this title and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this title” in section 19(c) of that Act [15 USCS § 78s(c)] shall, for purposes of this paragraph, be deemed to read “to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Sarbanes-Oxley Act of 2002 [15 USCS §§ 7211 et seq.], or otherwise further the purposes of that Act, the securities laws, and the rules and regulations thereunder applicable to that Board”.

(c) Commission review of disciplinary action taken by the Board.

(1) Notice of sanction. The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) Review of sanctions. The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 105(b)(3) of this Act [15 USCS § 7215(b)(3)] for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1) [15 USCS § 78s(d)(2), (e)(1)], except that, for purposes of this paragraph—

(A) section 105(e) of this Act [15 USCS § 7215(e)] (rather than that section 19(d)(2) [15 USCS § 78s(d)(2)]) shall govern the extent to which application for, or institution by the Commission on its own motion, of review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) [15 USCS § 78s(e)(1)] to “members” of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase “consistent with the purposes of this title” in that section 19(e)(1) [15 USCS § 78s(e)(1)] shall be deemed to read “consistent with the purposes of this title and title I of the Sarbanes-Oxley Act of 2002 [15 USCS §§ 78a et seq., 7211 et seq.]”;

(D) references to rules of the Municipal Securities Rulemaking Board in that section 19(e)(1) [15 USCS § 78s(e)(1)] shall not apply; and

(E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 [15 USCS § 78s(e)(2)] shall refer instead to section 107(c)(3) of this Act [15 USCS § 7217(c)(3)].

(3) Commission modification authority. The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) Censure of the Board; or other sanctions.

(1) Rescission of Board authority. The Commission, by rule, consistent with the public interest, the protection of investors, and the other

purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) Censure of the Board; limitations. The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) Censure of Board members; removal from office. The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member; or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

#### § 7218. Accounting standards

(a) [Omitted]

(b) Commission authority. The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933 [15 USCS § 77s(b)], as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors.

(c) No effect on Commission powers. Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) Study and report on adopting principles-based accounting.

(1) Study.

(A) In general. The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) Study topics. The study required by subparagraph (A) shall include an examination of—

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

(2) Report. Not later than 1 year after the date of enactment of this Act [enacted July 30, 2002], the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

#### § 7219. Funding

(a) In general. The Board, and the standard setting body designated pursuant to section 19(b) of the Securities Act of 1933 [15 USCS § 77s(b)], as amended by section 108 [15 USCS § 7218], shall be funded as provided in this section.

(b) Annual budgets. The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains (or at the beginning of the Board's first fiscal year, which may be a short fiscal year). The budget of the Board shall be subject to approval by the Commission. The budget for the first fiscal year of the Board shall be prepared and approved

promptly following the appointment of the initial five Board members, to permit action by the Board of the organizational tasks contemplated by section 101(d) [15 USCS § 7211(d)].

(c) Sources and uses of funds.

(1) Recoverable budget expenses. The budget of the Board (reduced by any registration or annual fees received under section 102(e) [15 USCS § 7212(e)] for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e). Accounting support fees and other receipts of the Board and of such standard-setting body shall not be considered public monies of the United States.

(2) Funds generated from the collection of monetary penalties. Subject to the availability in advance in an appropriations Act, and notwithstanding subsection (i), all funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) Annual accounting support fee for the Board.

(1) Establishment of fee. The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be necessary or appropriate to establish and maintain the Board. Such fee may also cover costs incurred in the Board's first fiscal year (which may be a short fiscal year), or may be levied separately with respect to such short fiscal year.

(2) Assessments. The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (g), allowing for differentiation among classes of issuers, as appropriate.

(e) Annual accounting support fee for standard setting body. The annual accounting support fee for the standard setting body referred to in subsection (a)—

(1) shall be allocated in accordance with subsection (g), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and

(2) may differentiate among different classes of issuers.

(f) Limitation on fee. The amount of fees collected under this section for a fiscal year on behalf of the Board or the standards setting body, as the case may be, shall not exceed the recoverable budget expenses of the Board or body, respectively (which may include operating, capital, and accrued items), referred to in subsection (c)(1).

(g) Allocation of accounting support fees among issuers. Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction—

(1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and

(2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(h) [Omitted]

(i) Rule of construction. Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

(j) Start-up expenses of the Board. From the unexpended balances of the appropriations to the Commission for fiscal year 2003, the Secretary of the Treasury is authorized to advance to the Board not to exceed the amount necessary to cover the expenses of the Board during its first

fiscal year (which may be a short fiscal year).

#### Auditor Independence

##### § 7231. Exemption authority

The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 [15 USCS § 78j-1(g)] (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107 [15 USCS § 7217].

##### § 7232. Study of mandatory rotation of registered public accounting firms

(a) Study and review required. The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms. (b) Report required. Not later than 1 year after the date of enactment of this Act [enacted July 30, 2002], the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section.

(c) Definition. For purposes of this section, the term “mandatory rotation” refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

##### § 7233. Commission authority

(a) Commission regulations. Not later than 180 days after the date of enactment of this Act [enacted July 30, 2002], the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934 [15 USCS § 78j-1], as added by this title.

(b) Auditor independence. It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934 [15 USCS § 78j-1], as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

§ 7234. Considerations by appropriate State regulatory authorities In supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized nonregistered public accounting firms.

#### Corporate Responsibility

##### § 7241. Corporate responsibility for financial reports

(a) Regulations required. The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that—

(1) the signing officer has reviewed the report;

(2) based on the officer’s knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;

(3) based on such officer’s knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;

(4) the signing officers—

(A) are responsible for establishing and maintaining internal controls;

(B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particu-

larly during the period in which the periodic reports are being prepared;

(C) have evaluated the effectiveness of the issuer’s internal controls as of a date within 90 days prior to the report; and

(D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;

(5) the signing officers have disclosed to the issuer’s auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—

(A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer’s ability to record, process, summarize, and report financial data and have identified for the issuer’s auditors any material weaknesses in internal controls; and

(B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer’s internal controls; and

(6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

(b) Foreign reincorporations have no effect. Nothing in this section 302 [this section] shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302 [this section], by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

(c) Deadline. The rules required by subsection (a) shall be effective not later than 30 days after the date of enactment of this Act [enacted July 30, 2002].

##### § 7242. Improper influence on conduct of audits

(a) Rules to prohibit. It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

(b) Enforcement. In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

(c) No preemption of other law. The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

(d) Deadline for rulemaking. The Commission shall—

(1) propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act [enacted July 30, 2002]; and

(2) issue final rules or regulations required by this section, not later than 270 days after that date of enactment [enacted July 30, 2002].

##### § 7243. Forfeiture of certain bonuses and profits

(a) Additional compensation prior to noncompliance with commission financial reporting requirements. If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) Commission exemption authority. The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

##### § 7244. Insider trades during pension fund blackout periods

(a) Prohibition of insider trading during pension fund blackout periods.

(1) In general. Except to the extent otherwise provided by rule of the Commission pursuant to paragraph (3), it shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during any blackout period with respect to such equity security if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer.

(2) Remedy.

(A) In general. Any profit realized by a director or executive officer referred to in paragraph (1) from any purchase, sale, or other acquisition or transfer in violation of this subsection shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such director or executive officer in entering into the transaction.

(B) Actions to recover profits. An action to recover profits in accordance with this subsection may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of request, or fails diligently to prosecute the action thereafter, except that no such suit shall be brought more than 2 years after the date on which such profit was realized.

(3) Rulemaking authorized. The Commission shall, in consultation with the Secretary of Labor, issue rules to clarify the application of this subsection and to prevent evasion thereof. Such rules shall provide for the application of the requirements of paragraph (1) with respect to entities treated as a single employer with respect to an issuer under section 414(b), (c), (m), or (o) of the Internal Revenue Code of 1986 [26 USCS § 414(b), (c), (m), or (o)] to the extent necessary to clarify the application of such requirements and to prevent evasion thereof. Such rules may also provide for appropriate exceptions from the requirements of this subsection, including exceptions for purchases pursuant to an automatic dividend reinvestment program or purchases or sales made pursuant to an advance election.

(4) Blackout period. For purposes of this subsection, the term “blackout period”, with respect to the equity securities of any issuer—

(A) means any period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan; and

(B) does not include, under regulations which shall be prescribed by the Commission—

(i) a regularly scheduled period in which the participants and beneficiaries may not purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer, if such period is—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before becoming participants under the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor.

(5) Individual account plan. For purposes of this subsection, the term “individual account plan” has the meaning provided in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34), except that such term shall not include a one-participant retirement plan (within the meaning of section 101(i)(8)(B) of such Act (29 U.S.C. 1021(i)(8)(B))).

(6) Notice to directors, executive officers, and the Commission. In any case in which a director or executive officer is subject to the requirements of this subsection in connection with a blackout period (as defined in paragraph (4)) with respect to any equity securities, the issuer of such equity securities shall timely notify such director or officer and the Securities and Exchange Commission of such blackout period.

(b) Notice requirements to participants and beneficiaries under ERISA.

(1) [Omitted]

(2) Issuance of initial guidance and model notice. The Secretary of Labor shall issue initial guidance and a model notice pursuant to sec-

tion 101(i)(6) of the Employee Retirement Income Security Act of 1974 [29 USCS § 1021(i)(6)] (as added by this subsection) not later than January 1, 2003. Not later than 75 days after the date of the enactment of this Act [enacted July 30, 2002], the Secretary shall promulgate interim final rules necessary to carry out the amendments made by this subsection.

(3) [Omitted]

[(4)](3) Plan amendments. If any amendment made by this subsection requires an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after the effective date of this section, if—

(A) during the period after such amendment made by this subsection takes effect and before such first plan year, the plan is operated in good faith compliance with the requirements of such amendment made by this subsection, and

(B) such plan amendment applies retroactively to the period after such amendment made by this subsection takes effect and before such first plan year.

(c) Effective date. The provisions of this section (including the amendments made thereby) shall take effect 180 days after the date of the enactment of this Act [enacted July 30, 2002]. Good faith compliance with the requirements of such provisions in advance of the issuance of applicable regulations thereunder shall be treated as compliance with such provisions.

§ 7245. Rules of professional responsibility for attorneys. Not later than 180 days after the date of enactment of this Act [enacted July 30, 2002], the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

§ 7246. Fair funds for investors

(a) Civil penalties added to disgorgement funds for the relief of victims. If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

(b) Acceptance of additional donations. The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United States for a disgorgement fund described in subsection (a). Such gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the disgorgement fund and shall be available for allocation in accordance with subsection (a).

(c) Study required.

(1) Subject of study. The Commission shall review and analyze—

(A) enforcement actions by the Commission over the five years preceding the date of the enactment of this Act [enacted July 30, 2002] that have included proceedings to obtain civil penalties or disgorgements to identify areas where such proceedings may be utilized to efficiently, effectively, and fairly provide restitution for injured investors; and

(B) other methods to more efficiently, effectively, and fairly provide restitution to injured investors, including methods to improve the collection rates for civil penalties and disgorgements.

(2) Report required. The Commission shall report its findings to the



Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after the date of the enactment of this Act [enacted July 30, 2002], and shall use such findings to revise its rules and regulations as necessary. The report shall include a discussion of regulatory or legislative actions that are recommended or that may be necessary to address concerns identified in the study.

(d) [Omitted]

(e) Definition. As used in this section, the term “disgorgement fund” means a fund established in any administrative or judicial proceeding described in subsection (a).

#### Enhanced Financial Disclosures

##### § 7261. Disclosures in periodic reports

(a) [Omitted]

(b) Commission rules on pro forma figures. Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002 [enacted July 30, 2002], the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

(c) Study and report on special purpose entities.

(1) Study required. The Commission shall, not later than 1 year after the effective date of adoption of off-balance sheet disclosure rules required by section 13(j) of the Securities Exchange Act of 1934 [15 USCS § 78m(j)], as added by this section, complete a study of filings by issuers and their disclosures to determine—

(A) the extent of off-balance sheet transactions, including assets, liabilities, leases, losses, and the use of special purpose entities; and

(B) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion.

(2) Report and recommendations. Not later than 6 months after the date of completion of the study required by paragraph (1), the Commission shall submit a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, setting forth—

(A) the amount or an estimate of the amount of off-balance sheet transactions, including assets, liabilities, leases, and losses of, and the use of special purpose entities by, issuers filing periodic reports pursuant to section 13 or 15 of the Securities Exchange Act of 1934 [15 USCS § 78m or 78o];

(B) the extent to which special purpose entities are used to facilitate off-balance sheet transactions;

(C) whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors in a transparent fashion;

(D) whether generally accepted accounting principles specifically result in the consolidation of special purpose entities sponsored by an issuer in cases in which the issuer has the majority of the risks and rewards of the special purpose entity; and

(E) any recommendations of the Commission for improving the transparency and quality of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission.

§ 7262. Management assessment of internal controls

(a) Rules required. The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) Internal control evaluation and reporting. With respect to the inter-

nal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

##### § 7263. Exemption

Nothing in section 401 [15 USCS § 7261], 402, or 404 [15 USCS § 7262], the amendments made by those sections, or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

##### § 7264. Code of ethics for senior financial officers

(a) Code of ethics disclosure. The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 [15 USCS § 78m(a) or 78o(d)], to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.

(b) Changes in codes of ethics. The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8-K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics for senior financial officers.

(c) Definition. In this section, the term “code of ethics” means such standards as are reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) Deadline for rulemaking. The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act [enacted July 30, 2002]; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

##### § 7265. Disclosure of audit committee financial expert

(a) Rules defining “financial expert”. The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934 [15 USCS §§ 78m(a), 78o(d)], to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

(b) Considerations. In defining the term “financial expert” for purposes of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—

(1) an understanding of generally accepted accounting principles and financial statements;

(2) experience in—

(A) the preparation or auditing of financial statements of generally comparable issuers; and

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;

(3) experience with internal accounting controls; and

(4) an understanding of audit committee functions.

(c) Deadline for rulemaking. The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act [enacted July 30, 2002]; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

##### § 7266. Enhanced review of periodic disclosures by issuers

(a) Regular and systematic review. The Commission shall review disclosures made by issuers reporting under section 13(a) of the Securities Exchange Act of 1934 [15 USCS § 78m(a)] (including reports filed on Form 10-K), and which have a class of securities listed on a national se-

curities exchange or traded on an automated quotation facility of a national securities association, on a regular and systematic basis for the protection of investors. Such review shall include a review of an issuer's financial statement.

#### **Federal Trade Commission Act 1914**

##### **Title 15. Commerce and Trade**

#### **Chapter 2. Federal Trade Commission; Promotion of Export Trade and Prevention of Unfair Methods of Competition**

§ 41. Federal Trade Commission established; membership; vacancies; A commission is created and established, to be known as the Federal Trade Commission (hereinafter referred to as the commission), which shall be composed of five commissioners, who shall be appointed by the President, by and with the advice and consent of the Senate. Not more than three of the commissioners shall be members of the same political party. The first commissioners appointed shall continue in office for terms of three, four, five, six, and seven years, respectively, from the date of taking effect of this Act, the term of each to be designated by the President, but their successors shall be appointed for terms of seven years, except that any person chosen to fill a vacancy shall be appointed only for the unexpired term of the commissioner whom he shall succeed: Provided, however, That upon the expiration of his term of office a Commissioner shall continue to serve until his successor shall have been appointed and shall have qualified. The commission [President] shall choose a chairman from its own [the commission's] membership. No commissioner shall engage in any other business, vocation, or employment. Any commissioner may be removed by the President for inefficiency, neglect of duty, or malfeasance in office. A vacancy in the commission shall not impair the right of the remaining commissioners to exercise all the powers of the commission.

##### **§ 44. Definitions**

The words defined in this section shall have the following meaning when found in this Act, to wit:

"Commerce" means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation.

"Corporation" shall be deemed to include any company, trust, so-called Massachusetts trust, or association, incorporated or unincorporated, which is organized to carry on business for its own profit or that of its members, and has shares of capital or capital stock or certificates of interest, and any company, trust, so-called Massachusetts trust, or association, incorporated or unincorporated, without shares of capital or capital stock or certificates of interest, except partnerships, which is organized to carry on business for its own profit or that of its members. "Documentary evidence" includes all documents, papers, correspondence, books of account, and financial and corporate records.

"Acts to regulate commerce" means the Act entitled "An Act to regulate commerce," approved February 14, 1887, and all Acts amendatory thereof and supplementary thereto [49 USCS §§ 10101 et seq.] and the Communications Act of 1934 and all Acts amendatory thereof and supplementary thereto.

"Antitrust Acts" means the Act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies," approved July 2, 1890; also sections 73 to 76 inclusive, of an Act entitled "An Act to reduce taxation, to provide revenue for the Government, and for other purposes," approved August 27, 1894 [15 USCS §§ 8-11]; also the Act entitled "An Act to amend sections 73 and 76, of the Act of August 27, 1894, entitled 'An Act to reduce taxation, to provide revenue for the Government, and for other purposes,'" approved February 12, 1913 [amending 15 USCS §§ 8, 11]; and also the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," approved October 15, 1914.

"Banks" means the types of banks and other financial institutions referred to in section 18(f)(2) [15 USCS § 57a(f)(2)].

§ 45. Unfair methods of competition unlawful; prevention by Commission

(a) Declaration of unlawfulness; power to prohibit unfair practices; inapplicability to foreign trade.

(1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are

hereby declared unlawful.

(2) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks, savings and loan institutions described in section 18(f)(3) [15 USCS § 57a(f)(3)], Federal credit unions described in section 18(f)(4) [15 USCS § 57a(f)(4)], common carriers subject to the Acts to regulate commerce, air carriers and foreign air carriers subject to the Federal Aviation Act of 1958 [49 USCS §§ 40101 et seq.], and persons, partnerships, or corporations insofar as they are subject to the Packers and Stockyards Act, 1921, as amended [7 USCS §§ 181 et seq.], except as provided in section 406(b) of said Act [7 USCS § 227(b)], from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.

(3) This subsection shall not apply to unfair methods of competition involving commerce with foreign nations (other than import commerce) unless—

(A) such methods of competition have a direct, substantial, and reasonably foreseeable effect—

(i) on commerce which is not commerce with foreign nations, or on import commerce with foreign nations; or

(ii) on export commerce with foreign nations, of a person engaged in such commerce in the United States; and

(B) such effect gives rise to a claim under the provisions of this subsection, other than this paragraph.

If this subsection applies to such methods of competition only because of the operation of subparagraph (A)(ii), this subsection shall apply to such conduct only for injury to export business in the United States.

(b) Proceeding by Commission; modifying and setting aside orders.

Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person, partnership, or corporation so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the Commission requiring such person, partnership, or corporation to cease and desist from the violation of the law so charged in said complaint. Any person, partnership, or corporation may make application, and upon good cause shown may be allowed by the Commission to intervene and appear in said proceeding by counsel or in person. The testimony in any such proceeding shall be reduced to writing and filed in the office of the Commission. If upon such hearing the Commission shall be of the opinion that the method of competition or the act or practice in question is prohibited by this Act, it shall make a report in writing in which it shall state its findings as to the facts and shall issue and cause to be served on such person, partnership, or corporation an order requiring such person, partnership, or corporation to cease and desist from using such method of competition or such act or practice. Until the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time, or, if a petition for review has been filed within such time then until the record in the proceeding has been filed in a court of appeals of the United States, as hereinafter provided, the Commission may at any time, upon such notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any report or any order made or issued by it under this section. After the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time, the Commission may at any time, after notice and opportunity for hearing, reopen and alter, modify, or set aside, in whole or in part, any report or order made or issued by it under this section, whenever in the opinion of the Commission conditions of fact or of law have so changed as to require such action or if the public interest shall so require, except that (1) the said person, partnership, or corporation may, within sixty days after the service upon him or it of said report or order entered after such a reopening, obtain a review thereof in the appropriate court of appeals of the United States, in the manner provided in subsection (c) of this section; and (2) in the case of an order, the Commission shall reopen any such order to consider whether such order (including any affirmative relief provision contained in such order)

should be altered, modified, or set aside, in whole or in part, if the person, partnership, or corporation involved files a request with the Commission which makes a satisfactory showing that changed conditions of law or fact require such order to be altered, modified, or set aside, in whole or in part. The Commission shall determine whether to alter, modify, or set aside any order of the Commission in response to a request made by a person, partnership, or corporation under paragraph [clause] (2) not later than 120 days after the date of the filing of such request.

(c) Review of order; rehearing. Any person, partnership, or corporation required by an order of the Commission to cease and desist from using any method of competition or act or practice may obtain a review of such order in the [circuit] court of appeals of the United States, within any circuit where the method of competition or the act or practice in question was used or where such person, partnership, or corporation resides or carries on business, by filing in the court, within sixty days from the date of the service of such order, a written petition praying that the order of the Commission be set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Commission, and thereupon the Commission shall file in the court the record in the proceeding, as provided in section 2112 of title 28, United States Code. Upon such filing of the petition the court shall have jurisdiction of the proceeding and of the question determined therein concurrently with the Commission until the filing of the record and shall have power to make and enter a decree affirming, modifying, or setting aside the order of the Commission, and enforcing the same to the extent that such order is affirmed and to issue such writs as are ancillary to its jurisdiction or are necessary in its judgment to prevent injury to the public or to competitors *pendente lite*. The findings of the Commission as to the facts, if supported by evidence, shall be conclusive. To the extent that the order of the Commission is affirmed, the court shall thereupon issue its own order commanding obedience to the terms of such order of the Commission. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, or make new findings, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of its original order, with the return of such additional evidence. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, as provided in section 240 of the Judicial Code [28 USCS § 1254].

(d) Jurisdiction of court. Upon the filing of the record with it the jurisdiction of the [circuit] court of appeals of the United States to affirm, enforce, modify, or set aside orders of the Commission shall be exclusive.

(e) Extension from liability. No order of the Commission or judgment of court to enforce the same shall in anywise relieve or absolve any person, partnership, or corporation from any liability under the Antitrust Acts.

(f) Service of complaints, orders and other processes; return. Complaints, orders, and other processes of the Commission under this section may be served by anyone duly authorized by the Commission, either (a) by delivering a copy thereof to the person to be served, or to a member of the partnership to be served, or the president, secretary, or other executive officer or a director of the corporation to be served; or (b) by leaving a copy thereof at the residence or the principal office or place of business of such person, partnership, or corporation; or (c) by mailing a copy thereof by registered mail or by certified mail addressed to such person, partnership, or corporation at his or its residence or principal office or place of business. The verified return by the person so serving said complaint, order, or other process setting forth the manner of said service shall be proof of the same, and the return post office receipt for said complaint, order, or other process mailed by registered mail or by certified mail as aforesaid shall be proof of the service of the same.

(g) Finality of order. An order of the Commission to cease and desist shall become final—

(1) Upon the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time; but the Commission may thereafter modify or set aside its order to the extent provided in the last sentence of subsection (b).

(2) Except as to any order provision subject to paragraph (4), upon the sixtieth day after such order is served, if a petition for review has been duly filed; except that any such order may be stayed, in whole or in part and subject to such conditions as may be appropriate, by—

(A) the Commission;

(B) an appropriate court of appeals of the United States, if (i) a petition for review of such order is pending in such court, and (ii) an application for such a stay was previously submitted to the Commission and the Commission, within the 30-day period beginning on the date the application was received by the Commission, either denied the application or did not grant or deny the application; or

(C) the Supreme Court, if an applicable petition for certiorari is pending.

(3) For purposes of subsection (m)(1)(B) and of section 19(a)(2) [15 USCS § 57b(a)(2)], if a petition for review of the order of the Commission has been filed—

(A) upon the expiration of the time allowed for filing a petition for certiorari, if the order of the Commission has been affirmed or the petition for review has been dismissed by the court of appeals and no petition for certiorari has been duly filed;

(B) upon the denial of a petition for certiorari, if the order of the Commission has been affirmed or the petition for review has been dismissed by the court of appeals; or

(C) upon the expiration of 30 days from the date of issuance of a mandate of the Supreme Court directing that the order of the Commission be affirmed or the petition for review be dismissed.

(4) In the case of an order provision requiring a person, partnership, or corporation to divest itself of stock, other share capital, or assets, if a petition for review of such order of the Commission has been filed—

(A) upon the expiration of the time allowed for filing a petition for certiorari, if the order of the Commission has been affirmed or the petition for review has been dismissed by the court of appeals and no petition for certiorari has been duly filed;

(B) upon the denial of a petition for certiorari, if the order of the Commission has been affirmed or the petition for review has been dismissed by the court of appeals; or

(C) upon the expiration of 30 days from the date of issuance of a mandate of the Supreme Court directing that the order of the Commission be affirmed or the petition for review be dismissed.

(h) Modification or setting aside of order by Supreme Court. If the Supreme Court directs that the order of the Commission be modified or set aside, the order of the Commission rendered in accordance with the mandate of the Supreme Court shall become final upon the expiration of thirty days from the time it was rendered, unless within such thirty days either party has instituted proceedings to have such order corrected to accord with the mandate, in which event the order of the Commission shall become final when so corrected.

(i) Modification or setting aside of order by Court of Appeals. If the order of the Commission is modified or set aside by the [circuit] court of appeals, and if (1) the time allowed for filing a petition for certiorari has expired and no such petition has been duly filed, or (2) the petition for certiorari has been denied, or (3) the decision of the court has been affirmed by the Supreme Court, then the order of the Commission rendered in accordance with the mandate of the court of appeals shall become final on the expiration of thirty days from the time such order of the Commission was rendered, unless within such thirty days either party has instituted proceedings to have such order corrected so that it will accord with the mandate, in which event the order of the Commission shall become final when so corrected.

(j) Rehearing upon order or remand. If the Supreme Court orders a rehearing; or if the case is remanded by the [circuit] court of appeals to the Commission for a rehearing, and if (1) the time allowed for filing a petition for certiorari has expired, and no such petition has been duly filed, or (2) the petition for certiorari has been denied, or (3) the decision of the court has been affirmed by the Supreme Court, then the order of the Commission rendered upon such rehearing shall become final in the same manner as though no prior order of the Commission had been rendered.

(k) “Mandate” defined. As used in this section the term “mandate,” in case a mandate has been recalled prior to the expiration of thirty days

from the date of issuance thereof, means the final mandate.

(l) Penalty for violation of order; injunctions and other appropriate equitable relief. Any person, partnership, or corporation who violates an order of the Commission after it has become final, and while such order is in effect, shall forfeit and pay to the United States a civil penalty of not more than \$ 10,000 for each violation, which shall accrue to the United States and may be recovered in a civil action brought by the Attorney General of the United States. Each separate violation of such an order shall be a separate offense, except that in the case of a violation through continuing failure to obey or neglect to obey a final order of the Commission, each day of continuance of such failure or neglect shall be deemed a separate offense. In such actions, the United States district courts are empowered to grant mandatory injunctions and such other and further equitable relief as they deem appropriate in the enforcement of such final orders of the Commission.

(m) Civil actions for recovery of penalties for knowing violations of rules and cease and desist orders respecting unfair or deceptive acts or practices; jurisdiction; maximum amount of penalties; continuing violations; de novo determinations; compromise or settlement procedure.

(1) (A) The Commission may commence a civil action to recover a civil penalty in a district court of the United States against any person, partnership, or corporation which violates any rule under this Act respecting unfair or deceptive acts or practices (other than an interpretive rule or a rule violation of which the Commission has provided is not an unfair or deceptive act or practice in violation of subsection (a)(1)) with actual knowledge or knowledge fairly implied on the basis of objective circumstances that such act is unfair or deceptive and is prohibited by such rule. In such action, such person, partnership, or corporation shall be liable for a civil penalty of not more than \$ 10,000 for each violation.

(B) If the Commission determines in a proceeding under subsection (b) that any act or practice is unfair or deceptive, and issues a final cease and desist order, other than a consent order, with respect to such act or practice, then the Commission may commence a civil action to obtain a civil penalty in a district court of the United States against any person, partnership, or corporation which engages in such act or practice—

(1) after such cease and desist order becomes final (whether or not such person, partnership, or corporation was subject to such cease and desist order), and

(2) with actual knowledge that such act or practice is unfair or deceptive and is unlawful under subsection (a)(1) of this section.

In such action, such person, partnership, or corporation shall be liable for a civil penalty of not more than \$ 10,000 for each violation.

(C) In the case of a violation through continuing failure to comply with a rule or with section 5(a)(1) [subsec. (a)(1) of this section], each day of continuance of such failure shall be treated as a separate violation, for purposes of subparagraphs (A) and (B). In determining the amount of such a civil penalty, the court shall take into account the degree of culpability, any history of prior such conduct, ability to pay, effect on ability to continue to do business, and such other matters as justice may require.

(2) If the cease and desist order establishing that the act or practice is unfair or deceptive was not issued against the defendant in a civil penalty action under paragraph (1)(B) the issues of fact in such action against such defendant shall be tried de novo. Upon request of any party to such an action against such defendant, the court shall also review the determination of law made by the Commission in the proceeding under subsection (b) that the act or practice which was the subject of such proceeding constituted an unfair or deceptive act or practice in violation of subsection (a).

(3) The Commission may compromise or settle any action for a civil penalty if such compromise or settlement is accompanied by a public statement of its reasons and is approved by the court.

(n) Definition of unfair acts or practices. The Commission shall have no authority under this section or section 18 [15 USCS § 57a] to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

#### § 45a. Labels on products

To the extent any person introduces, delivers for introduction, sells, advertises, or offers for sale in commerce a product with a “Made in the U.S.A.” or “Made in America” label, or the equivalent thereof, in order to represent that such product was in whole or substantial part of domestic origin, such label shall be consistent with decisions and orders of the Federal Trade Commission issued pursuant to section 5 of the Federal Trade Commission Act [15 USCS § 45]. This section only applies to such labels. Nothing in this section shall preclude the application of other provisions of law relating to labeling. The Commission may periodically consider an appropriate percentage of imported components which may be included in the product and still be reasonably consistent with such decisions and orders. Nothing in this section shall preclude use of such labels for products that contain imported components under the label when the label also discloses such information in a clear and conspicuous manner. The Commission shall administer this section pursuant to section 5 of the Federal Trade Commission Act [15 USCS § 45] and may from time to time issue rules pursuant to section 553 of title 5, United States Code, for such purpose. If a rule is issued, such violation shall be treated by the Commission as a violation of a rule under section 18 of the Federal Trade Commission Act (15 U.S.C. 57a) regarding unfair or deceptive acts or practices. This section shall be effective upon publication in the Federal Register of a Notice of the provisions of this section. The Commission shall publish such notice within six months after the enactment of this section [Sept. 13, 1994].

#### § 46. Additional powers of Commission

The commission shall also have power—

(a) Investigation of persons, partnerships, or corporations. To gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any person, partnership, or corporation engaged in or whose business affects commerce, excepting banks, savings and loan institutions described in section 18(f)(3) [15 USCS § 57a(f)(3)], Federal credit unions described in section 18(f)(4) [15 USCS § 57a(f)(4)], and common carriers subject to the Act to regulate commerce, and its relation to other persons, partnerships, and corporations.

(b) Reports of persons, partnerships, and corporations. To require, by general or special orders, persons, partnerships, and corporations engaged in or whose business affects commerce, excepting banks, savings and loan institutions described in section 18(f)(3) [15 USCS § 57a(f)(3)], Federal credit unions described in section 18(f)(4) [15 USCS § 57a(f)(4)], and common carriers subject to the Act to regulate commerce, or any class of them, or any of them, respectively, to file with the commission in such form as the commission may prescribe annual or special, or both annual and special, reports, or answers in writing to specific questions, furnishing to the commission such information as it may require as to the organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals of the respective persons, partnerships, and corporations filing such reports or answers in writing. Such reports and answers shall be made under oath, or otherwise, as the commission may prescribe, and shall be filed with the commission within such reasonable period as the commission may prescribe, unless additional time be granted in any case by the commission.

(c) Investigation of compliance with antitrust decrees. Whenever a final decree has been entered against any defendant corporation in any suit brought by the United States to prevent and restrain any violation of the antitrust Acts, to make investigation, upon its own initiative, of the manner in which the decree has been or is being carried out, and upon the application of the Attorney General it shall be its duty to make such investigation. It shall transmit to the Attorney General a report embodying its findings and recommendations as a result of any such investigation, and the report shall be made public in the discretion of the commission.

(d) Investigations of violations of antitrust statutes. Upon the direction of the President or either House of Congress to investigate and report the facts relating to any alleged violations of the antitrust Acts by any corporation.

(e) Readjustment of business of corporations violating antitrust statutes. Upon the application of the Attorney General to investigate and make recommendations for the readjustment of the business of any corporation alleged to be violating the antitrust Acts in order that the corporation may thereafter maintain its organization, management, and conduct of business in accordance with law.

(f) Publication of information; reports. To make public from time to time such portions of the information obtained by it hereunder as are in the public interest; and to make annual and special reports to the Congress and to submit therewith recommendations for additional legislation; and to provide for the publication of its reports and decisions in such form and manner as may be best adapted for public information and use: Provided, That the Commission shall not have any authority to make public any trade secret or any commercial or financial information which is obtained from any person and which is privileged or confidential, except that the Commission may disclose such information to officers and employees of appropriate Federal law enforcement agencies or to any officer or employee of any State law enforcement agency upon the prior certification of an officer of any such Federal or State law enforcement agency that such information will be maintained in confidence and will be used only for official law enforcement purposes.

(g) Classification of corporations; regulations. From time to time to classify corporations and (except as provided in section 18(a)(2) of this Act [15 USCS § 57a(a)(2)]) to make rules and regulations for the purpose of carrying out the provisions of this Act.

(h) Investigations of foreign trade conditions; reports. To investigate, from time to time, trade conditions in and with foreign countries where associations, combinations, or practices of manufacturers, merchants, or traders, or other conditions, may affect the foreign trade of the United States, and to report to Congress thereon, with such recommendations as it deems advisable.

(i) With respect to the International Antitrust Enforcement Assistance Act of 1994, to conduct investigations of possible violations of foreign antitrust laws (as defined in section 12 of such Act [15 USCS § 6211]). Provided, That the exception of "banks, savings and loan institutions described in section 18(f)(3) [15 USCS § 57a(f)(3)], Federal credit unions described in section 18(f)(4) [15 USCS § 57a(f)(4)], and common carriers subject to the Act to regulate commerce" from the Commission's powers defined in clauses (a) and (b) of this section, shall not be construed to limit the Commission's authority to gather and compile information, to investigate, or to require reports or answers from, any person, partnership, or corporation to the extent that such action is necessary to the investigation of any person, partnership, or corporation, group of persons, partnerships, or corporations, or industry which is not engaged or is engaged only incidentally in banking, in business as a savings and loan institution, in business as a Federal credit union, or in business as a common carrier subject to the Act to regulate commerce.

The Commission shall establish a plan designed to substantially reduce burdens imposed upon small businesses as a result of requirements established by the Commission under clause (b) relating to the filing of quarterly financial reports. Such plan shall (1) be established after consultation with small businesses and persons who use the information contained in such quarterly financial reports; (2) provide for a reduction of the number of small businesses required to file such quarterly financial reports; and (3) make revisions in the forms used for such quarterly financial reports for the purpose of reducing the complexity of such forms. The Commission, not later than December 31, 1980, shall submit such plan to the Committee on Commerce, Science, and Transportation of the Senate and to the Committee on Energy and Commerce of the House of Representatives. Such plan shall take effect not later than October 31, 1981.

No officer or employee of the Commission or any Commissioner may publish or disclose information to the public, or to any Federal agency, whereby any line-of-business data furnished by a particular establishment or individual can be identified. No one other than designated sworn officers and employees of the Commission may examine the line-of-business reports from individual firms, and information provided in the line-of-business program administered by the Commission shall be used only for statistical purposes. Information for carrying out specific law enforcement responsibilities of the Commission shall be obtained under practices and procedures in effect on the date of the enactment of the Federal Trade Commission Improvements Act of 1980 [enacted May 28, 1980], or as changed by law.

Nothing in this section (other than the provisions of clause (c) and clause (d)) shall apply to the business of insurance, except that the Commission shall have authority to conduct studies and prepare reports relating to the business of insurance. The Commission may exercise such authority only upon receiving a request which is agreed to by a majority of the members of the Committee on Commerce, Science,

and Transportation of the Senate or the Committee on Energy and Commerce of the House of Representatives. The authority to conduct any such study shall expire at the end of the Congress during which the request for such study was made.

§ 47. Reference of suits under antitrust statutes to Commission. In any suit in equity brought by or under the direction of the Attorney General as provided in the antitrust Acts, the court may, upon the conclusion of the testimony therein, if it shall be then of opinion that the complainant is entitled to relief, refer said suit to the commission, as a master in chancery, to ascertain and report an appropriate form of decree therein. The commission shall proceed upon such notice to the parties and under such rules of procedure as the court may prescribe, and upon the coming in of such report such exceptions may be filed and such proceedings had in relation thereto as upon the report of a master in other equity causes, but the court may adopt or reject such report, in whole or in part, and enter such decree as the nature of the case may in its judgment require.

§ 49. Documentary evidence; depositions; witnesses

For the purposes of this Act the commission, or its duly authorized agent or agents, shall at all reasonable times have access to, for the purpose of examination, and the right to copy any documentary evidence of any person, partnership, or corporation being investigated or proceeded against; and the commission shall have power to require by subpoena the attendance and testimony of witnesses and the production of all such documentary evidence relating to any matter under investigation. Any member of the commission may sign subpoenas, and members and examiners of the commission may administer oaths and affirmations, examine witnesses, and receive evidence.

Such attendance of witnesses and the production of such documentary evidence, may be required from any place in the United States, at any designated place of hearing. And in case of disobedience to a subpoena the commission may invoke the aid of any court of the United States in requiring the attendance and testimony of witnesses and the production of documentary evidence.

Any of the district courts of the United States within the jurisdiction of which such inquiry is carried on may, in case of contumacy or refusal to obey a subpoena issued to any person, partnership, or corporation, issue an order requiring such person, partnership, or corporation to appear before the commission, or to produce documentary evidence if so ordered, or to give evidence touching the matter in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof.

Upon the application of the Attorney General of the United States, at the request of the commission, the district courts of the United States shall have jurisdiction to issue writs of mandamus commanding any person, partnership, or corporation to comply with this Act or any order of the commission made in pursuance thereof.

The commission may order testimony to be taken by deposition in any proceeding or investigation pending under this Act at any stage of such proceeding or investigation. Such depositions may be taken before any person designated by the commission and having power to administer oaths. Such testimony shall be reduced to writing by the person taking the deposition, or under his direction, and shall then be subscribed by the deponent. Any person may be compelled to appear and depose and to produce documentary evidence in the same manner as witnesses may be compelled to appear and testify and produce documentary evidence before the commission as hereinbefore provided.

Witnesses summoned before the commission shall be paid the same fees and mileage that are paid witnesses in the courts of the United States, and witnesses whose depositions are taken and the persons taking the same shall severally be entitled to the same fees as are paid for like services in the courts of the United States.

§ 50. Offenses and penalties

Any person who shall neglect or refuse to attend and testify, or to answer any lawful inquiry or to produce any documentary evidence, if in his power to do so, in obedience to an order of a district court of the United States directing compliance with the subpoena or lawful requirement of the commission, shall be guilty of an offense and upon conviction thereof by a court of competent jurisdiction shall be punished by a fine of not less than \$ 1,000 nor more than \$ 5,000, or by imprisonment for not more than one year, or by both such fine and imprisonment.

Any person who shall willfully make or cause to be made, any false entry or statement of fact in any report required to be made under this

Act, or who shall willfully make, or cause to be made, any false entry in any account, record, or memorandum kept by any person, partnership, or corporation subject to this Act, or who shall willfully neglect or fail to make, or cause to be made, full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of such person, partnership, or corporation, or who shall willfully remove out of the jurisdiction of the United States, or willfully mutilate, alter, or by any other means falsify any documentary evidence of such person, partnership, or corporation, or who shall willfully refuse to submit to the commission or to any of its authorized agents, for the purpose of inspection and taking copies, any documentary evidence of such person, partnership, or corporation in his possession or within his control, shall be deemed guilty of an offense against the United States, and shall be subject, upon conviction in any court of the United States of competent jurisdiction, to a fine of not less than \$ 1,000 nor more than \$ 5,000, or to imprisonment for a term of not more than three years, or to both such fine and imprisonment. If any persons, partnership or corporation required by this Act to file any annual or special report shall fail so to do within the time fixed by the commission for filing the same, and such failure shall continue for thirty days after notice of such default, the corporation shall forfeit to the United States the sum of \$ 100 for each and every day of the continuance of such failure, which forfeiture shall be payable into the Treasury of the United States, and shall be recoverable in a civil suit in the name of the United States brought in the case of a corporation or partnership in the district where the corporation or partnership has its principal office or in any district in which it shall do business, and in the case of any person in the district where such person resides or has his principal place of business. It shall be the duty of the various district attorneys [United States attorneys], under the direction of the Attorney General of the United States, to prosecute for the recovery of forfeitures. The costs and expenses of such prosecution shall be paid out of the appropriation for the expenses of the courts of the United States.

Any officer or employee of the commission who shall make public any information obtained by the commission without its authority, unless directed by a court, shall be deemed guilty of a misdemeanor, and, upon conviction thereof, shall be punished by a fine not exceeding \$ 5,000, or by imprisonment not exceeding one year, or by fine and imprisonment, in the discretion of the court.

#### § 52. Dissemination of false advertisements

(a) Unlawfulness. It shall be unlawful for any person, partnership, or corporation to disseminate, or cause to be disseminated, any false advertisement—

(1) By United States mails, or in or having an effect upon commerce, by any means, for the purpose of inducing, or which is likely to induce, directly or indirectly the purchase of foods, drugs, devices, services, or cosmetics; or

(2) By any means, for the purpose of inducing, or which is likely to induce, directly or indirectly, the purchase in or having an effect upon commerce of food, drugs, devices, services, or cosmetics.

(b) Unfair or deceptive act or practice. The dissemination or the causing to be disseminated of any false advertisement within the provisions of subsection (a) of this section shall be an unfair or deceptive act or practice in or affecting commerce within the meaning of section 5 [15 USCS § 45].

#### § 53. False advertisements; injunctions and restraining orders

(a) Power of Commission; jurisdiction of courts. Whenever the Commission has reason to believe—

(1) that any person, partnership, or corporation is engaged in, or is about to engage in, the dissemination or the causing of the dissemination of any advertisement in violation of section 12 [15 USCS § 52], and

(2) that the enjoining thereof pending the issuance of a complaint by the Commission under section 5 [15 USCS § 45], and until such complaint is dismissed by the Commission or set aside by the court on review, or the order of the Commission to cease and desist made thereon has become final within the meaning of section 5 [15 USCS § 45], would be to the interest of the public, the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States or in the United States court of any Territory, to enjoin the dissemination or the causing of the dissemination of such advertisement. Upon proper showing a temporary injunction or restraining order shall be granted without bond. Any suit may

be brought where such person, partnership, or corporation resides or transacts business, or wherever venue is proper under section 1391 of title 28, United States Code. In addition, the court may, if the court determines that the interests of justice require that any other person, partnership, or corporation should be a party in such suit, cause such other person, partnership, or corporation to be added as a party without regard to whether venue is otherwise proper in the district in which the suit is brought. In any suit under this section, process may be served on any person, partnership, or corporation wherever it may be found.

(b) Temporary restraining orders; preliminary injunctions. Whenever the Commission has reason to believe

(1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and

(2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond: Provided, however, That if a complaint is not filed within such period (not exceeding 20 days) as may be specified by the court after issuance of the temporary restraining order or preliminary injunction, the order or injunction shall be dissolved by the court and be of no further force and effect: Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction. Any suit may be brought where such person, partnership, or corporation resides or transacts business, or wherever venue is proper under section 1391 of title 28, United States Code. In addition, the court may, if the court determines that the interests of justice require that any other person, partnership, or corporation should be a party in such suit, cause such other person, partnership, or corporation to be added as a party without regard to whether venue is otherwise proper in the district in which the suit is brought. In any suit under this section, process may be served on any person, partnership, or corporation wherever it may be found.

(c) Service of process of the Commission; proof of service. Any process of the Commission under this section may be served by any person duly authorized by the Commission—

(1) by delivering a copy of such process to the person to be served, to a member of the partnership to be served, or to the president, secretary, or other executive officer or a director of the corporation to be served;

(2) by leaving a copy of such process at the residence or the principal office or place of business of such person, partnership, or corporation; or

(3) by mailing a copy of such process by registered mail or certified mail addressed to such person, partnership, or corporation at his, or her, or its residence, principal office, or principal place or business. The verified return by the person serving such process setting forth the manner of such service shall be proof of the same.

(d) Exception of periodical publications. Whenever it appears to the satisfaction of the court in the case of a newspaper, magazine, periodical, or other publication, published at regular intervals—

(1) that restraining the dissemination of a false advertisement in any particular issue of such publication would delay the delivery of such issue after the regular time therefor, and

(2) that such delay would be due to the method by which the manufacture and distribution of such publication is customarily conducted by the publisher in accordance with sound business practice, and not to any method or device adopted for the evasion of this section or to prevent or delay the issuance of an injunction or restraining order with respect to such false advertisement or any other advertisement, the court shall exclude such issue from the operation of the restraining order or injunction.

#### § 54. False advertisements; penalties

(a) Imposition of penalties. Any person, partnership, or corporation who violates any provision of section 12(a) [15 USCS § 52(a)] shall, if

the use of the commodity advertised may be injurious to health because of results from such use under the conditions prescribed in the advertisement thereof, or under such conditions as are customary or usual, or if such violation is with intent to defraud or mislead, be guilty of a misdemeanor, and upon conviction shall be punished by a fine of not more than \$ 5,000 or by imprisonment for not more than six months, or by both such fine and imprisonment; except that if the conviction is for a violation committed after a first conviction of such person, partnership, or corporation, for any violation of such section, punishment shall be by a fine of not more than \$ 10,000 or by imprisonment for not more than one year, or by both such fine and imprisonment: Provided, That for the purposes of this section meats and meat food products duly inspected, marked, and labeled in accordance with rules and regulations issued under the Meat Inspection Act approved March 4, 1907, as amended, shall be conclusively presumed not injurious to health at the time the same leave official "establishments." (b) Exception of advertising medium or agency. No publisher, radio-broadcast licensee, or agency or medium for the dissemination of advertising, except the manufacturer, packer, distributor, or seller of the commodity to which the false advertisement relates, shall be liable under this section by reason of the dissemination by him of any false advertisement, unless he has refused, on the request of the Commission, to furnish the Commission the name and post-office address of the manufacturer, packer, distributor, seller, or advertising agency, residing in the United States, who caused him to disseminate such advertisement. No advertising agency shall be liable under this section by reason of the causing by it of the dissemination of any false advertisement, unless it has refused, on the request of the Commission, to furnish the Commission the name and post-office address of the manufacturer, packer, distributor, or seller, residing in the United States, who caused it to cause the dissemination of such advertisement.

#### § 55. Additional definitions

For the purposes of sections 12, 13 and 14 [15 USCS §§ 52, 53, 54]—

##### (a) False advertisement.

(1) The term "false advertisement" means an advertisement, other than labeling, which is misleading in a material respect; and in determining whether any advertisement is misleading, there shall be taken into account (among other things) not only representations made or suggested by statement, word, design, device, sound, or any combination thereof, but also the extent to which the advertisement fails to reveal facts material in the light of such representations or material with respect to consequences which may result from the use of the commodity to which the advertisement relates under the conditions prescribed in said advertisement, or under such conditions as are customary or usual. No advertisement of a drug shall be deemed to be false if it is disseminated only to members of the medical profession, contains no false representation of a material fact, and includes, or is accompanied in each instance by truthful disclosure of, the formula showing quantitatively each ingredient of such drug.

(2) In the case of oleomargarine or margarine an advertisement shall be deemed misleading in a material respect if in such advertisement representations are made or suggested by statement, word, grade designation, design, device, symbol, sound, or any combination thereof, that such oleomargarine or margarine is a dairy product, except that nothing contained herein shall prevent a truthful, accurate, and full statement in any such advertisement of all the ingredients contained in such oleomargarine or margarine.

(b) Food. The term "food" means (1) articles used for food or drink for man or other animals, (2) chewing gum, and (3) articles used for components of any such article.

(c) Drug. The term "drug" means (1) articles recognized in the official United States Pharmacopoeia, official Homoeopathic Pharmacopoeia of the United States, or official National Formulary, or any supplement to any of them; and (2) articles intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in man or other animals; and (3) articles (other than food) intended to affect the structure or any function of the body of man or other animals; and (4) articles intended for use as a component of any article specified in clause (1), (2), or (3); but does not include devices or their components, parts, or accessories.

(d) Device. The term "device" (except when used in subsection (a) of this section) means an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent, or other similar or related article, including any component, part, or accessory, which is—

(1) recognized in the official National Formulary, or the United States Pharmacopoeia, or any supplement to them,

(2) intended for use in the diagnosis of disease or other conditions, or in the cure, mitigation, treatment, or prevention of disease, in man or other animals, or

(3) intended to affect the structure or any function of the body of man or other animals, and which does not achieve any of its principal intended purposes through chemical action within or on the body of man or other animals and which is not dependent upon being metabolized for the achievement of any of its principal intended purposes. (e) Cosmetic. The term "cosmetic" means (1) articles to be rubbed, poured, sprinkled, or sprayed on, introduced into, or otherwise applied to the human body or any part thereof intended for cleansing, beautifying, promoting attractiveness, or altering the appearance, and (2) articles intended for use as a component of any such article; except that such term shall not include soap.

(f) Oleomargarine or margarine. For the purpose of this section and section 407 of the Federal Food, Drug, and Cosmetic Act, as amended [21 USCS § 347], the term "oleomargarine" or "margarine" includes—

(1) all substances, mixtures, and compounds known as oleomargarine or margarine;

(2) all substances, mixtures, and compounds which have a consistency similar to that of butter and which contain any edible oils or fats other than milk fat if made in imitation or semblance of butter.

#### § 57. Separability clause

If any provision of this Act or the application thereof to any person, partnership, corporation, or circumstance, is held invalid, the remainder of the Act and the application of such provision to any other person, partnership, corporation, or circumstance, shall not be affected thereby.

§ 57b. Civil actions for violations of rules and cease and desist orders respecting unfair or deceptive acts or practices

(a) Suits by Commission against persons, partnerships, or corporations; jurisdiction; relief for dishonest or fraudulent acts.

(1) If any person, partnership, or corporation violates any rule under this Act respecting unfair or deceptive acts or practices (other than an interpretive rule, or a rule violation of which the Commission has provided is not an unfair or deceptive act or practice in violation of section 5(a) [15 USCS § 45(a)]), then the Commission may commence a civil action against such person, partnership, or corporation for relief under subsection (b) in a United States district court or in any court of competent jurisdiction of a State.

(2) If any person, partnership, or corporation engages in any unfair or deceptive act or practice (within the meaning of section 5(a)(1) [15 USCS § 45(a)(1)]) with respect to which the Commission has issued a final cease and desist order which is applicable to such person, partnership, or corporation, then the Commission may commence a civil action against such person, partnership, or corporation in a United States district court or in any court of competent jurisdiction of a State. If the Commission satisfies the court that the act or practice to which the cease and desist order relates is one which a reasonable man would have known under the circumstances was dishonest or fraudulent, the court may grant relief under subsection (b).

(b) Nature of relief available. The court in an action under subsection

(a) shall have jurisdiction to grant such relief as the court finds necessary to redress injury to consumers or other persons, partnership, and corporations resulting from the rule violation or the unfair or deceptive act or practice, as the case may be. Such relief may include, but shall not be limited to, rescission or reformation of contracts, the refund of money or return of property, the payment of damages, and public notification respecting the rule violation or the unfair or deceptive act or practice, as the case may be; except that nothing in this subsection is intended to authorize the imposition of any exemplary or punitive damages.

(c) Conclusiveness of findings of Commission in cease and desist proceedings; notice of judicial proceedings to injured persons, etc.

(1) If (A) a cease and desist order issued under section 5(b) [15 USCS § 45(b)] has become final under section 5(g) [15 USCS § 45(g)] with respect to any person's, partnership's, or corporation's rule violation or unfair or deceptive act or practice, and (B) an action under this section is brought with respect to such person's, partnership's, or corporation's rule violation or act or practice, then the findings of the Commission as to the material facts in the proceeding under section 5(b) [15 USCS § 45(b)] with respect to such person's, partnership's, or corporation's rule

violation or act or practice, shall be conclusive unless (i) the terms of such cease and desist order expressly provide that the Commission's findings shall not be conclusive, or (ii) the order became final by reason of section 5(g)(1) [15 USCS § 45(g)(1)], in which case such finding shall be conclusive if supported by evidence.

(2) The court shall cause notice of an action under this section to be given in a manner which is reasonably calculated, under all of the circumstances, to apprise the persons, partnerships, and corporations allegedly injured by the defendant's rule violation or act or practice of the pendency of such action. Such notice may, in the discretion of the court, be given by publication.

(d) Time for bringing of actions. No action may be brought brought by the Commission under this section more than 3 years after the rule violation to which an action under subsection (a)(1) relates, or the unfair or deceptive act or practice to which an action under subsection (a)(2) relates; except that if a cease and desist order with respect to any person's, partnership's, or corporation's rule violation or unfair or deceptive act or practice has become final and such order was issued in a proceeding under section 5(b) [15 USCS § 45(b)] which was commenced not later than 3 years after the rule violation or act or practice occurred, a civil action may be commenced under this section against such person, partnership, or corporation at any time before the expiration of one year after such order becomes final.

(e) Availability of additional Federal or State remedies; other authority of Commission unaffected. Remedies provided in this section are in addition to, and not in lieu of, any other remedy or right of action provided by State or Federal law. Nothing in this section shall be construed to affect any authority of the Commission under any other provision of law.

#### § 57b-2. Confidentiality

(a) Definitions. For purposes of this section:

(1) The term "material" means documentary material, tangible things, written reports or answers to questions, and transcripts of oral testimony.

(2) The term "Federal agency" has the meaning given it in section 552(e) of title 5, United States Code.

(b) Procedures respecting documents, tangible things, or transcripts of oral testimony received pursuant to compulsory process in investigation.

(1) With respect to any document, tangible thing, or transcript of oral testimony received by the Commission pursuant to compulsory process in an investigation, a purpose of which is to determine whether any person may have violated any provision of the laws administered by the Commission, the procedures established in paragraph (2) through paragraph (7) shall apply.

(2) (A) The Commission shall designate a duly authorized agent to serve as custodian of documentary material, tangible things, or written reports or answers to questions, and transcripts of oral testimony, and such additional duly authorized agents as the Commission shall determine from time to time to be necessary to serve as deputies to the custodian.

(B) Any person upon whom any demand for the production of documentary material has been duly served shall make such material available for inspection and copying or reproduction to the custodian designated in such demand at the principal place of business of such person (or at such other place as such custodian and such person thereafter may agree and prescribe in writing or as the court may direct pursuant to section 20(h) [15 USCS § 57b-1(h)]) on the return date specified in such demand (or on such later date as such custodian may prescribe in writing). Such person may upon written agreement between such person and the custodian substitute copies for originals of all or any part of such material.

(3) (A) The custodian to whom any documentary material, tangible things, written reports or answers to questions, and transcripts of oral testimony are delivered shall take physical possession of such material, reports or answers, and transcripts, and shall be responsible for the use made of such material, reports or answers, and transcripts, and for the return of material, pursuant to the requirements of this section.

(B) The custodian may prepare such copies of the documentary material, written reports or answers to questions, and transcripts of oral testimony, and may make tangible things available, as may be required for official use by any duly authorized officer or employee of the Commission under regulations which shall be promulgated by the Commission. Notwithstanding subparagraph (C), such material, things, and

transcripts may be used by any such officer or employee in connection with the taking of oral testimony under this section.

(C) Except as otherwise provided in this section, while in the possession of the custodian, no documentary material, tangible things, reports or answers to questions, and transcripts of oral testimony shall be available for examination by any individual other than a duly authorized officer or employee of the Commission without the consent of the person who produced the material, things, or transcripts. Nothing in this section is intended to prevent disclosure to either House of the Congress or to any committee or subcommittee of the Congress, except that the Commission immediately shall notify the owner or provider of any such information of a request for information designated as confidential by the owner or provider.

(D) While in the possession of the custodian and under such reasonable terms and conditions as the Commission shall prescribe—

(i) documentary material, tangible things, or written reports shall be available for examination by the person who produced the material, or by any duly authorized representative of such person; and

(ii) answers to questions in writing and transcripts of oral testimony shall be available for examination by the person who produced the testimony or by his attorney.

(4) Whenever the Commission has instituted a proceeding against a person, partnership, or corporation, the custodian may deliver to any officer or employee of the Commission documentary material, tangible things, written reports or answers to questions, and transcripts of oral testimony for official use in connection with such proceeding. Upon the completion of the proceeding, the officer or employee shall return to the custodian any such material so delivered which has not been received into the record of the proceeding.

(5) If any documentary material, tangible things, written reports or answers to questions, and transcripts of oral testimony have been produced in the course of any investigation by any person pursuant to compulsory process and—

(A) any proceeding arising out of the investigation has been completed; or

(B) no proceeding in which the material may be used has been commenced within a reasonable time after completion of the examination and analysis of all such material and other information assembled in the course of the investigation;

then the custodian shall, upon written request of the person who produced the material, return to the person any such material which has not been received into the record of any such proceeding (other than copies of such material made by the custodian pursuant to paragraph (3)(B)).

(6) The custodian of any documentary material, written reports or answers to questions, and transcripts of oral testimony may deliver to any officers or employees of appropriate Federal law enforcement agencies, in response to a written request, copies of such material for use in connection with an investigation or proceeding under the jurisdiction of any such agency. The custodian of any tangible things may make such things available for inspection to such persons on the same basis. Such materials shall not be made available to any such agency until the custodian receives certification of any officer of such agency that such information will be maintained in confidence and will be used only for official law enforcement purposes. Such documentary material, results of inspections of tangible things, written reports or answers to questions, and transcripts of oral testimony may be used by any officer or employee of such agency only in such manner and subject to such conditions as apply to the Commission under this section. The custodian may make such materials available to any State law enforcement agency upon the prior certification of any officer of such agency that such information will be maintained in confidence and will be used only for official law enforcement purposes.

(7) In the event of the death, disability, or separation from service in the Commission of the custodian of any documentary material, tangible things, written reports or answers to questions, and transcripts of oral testimony produced under any demand issued under this Act, or the official relief of the custodian from responsibility for the custody and control of such material, the Commission promptly shall—

(A) designate under paragraph (2)(A) another duly authorized agent to serve as custodian of such material; and

(B) transmit in writing to the person who produced the material or testimony notice as to the identity and address of the successor so designated.



Any successor designated under paragraph (2)(A) as a result of the requirements of this paragraph shall have (with regard to the material involved) all duties and responsibilities imposed by this section upon his predecessor in office with regard to such material, except that he shall not be held responsible for any default or dereliction which occurred before his designation.

(c) Information considered confidential.

(1) All information reported to or otherwise obtained by the Commission which is not subject to the requirements of subsection (b) shall be considered confidential when so marked by the person supplying the information and shall not be disclosed, except in accordance with the procedures established in paragraph (2) and paragraph (3).

(2) If the Commission determines that a document marked confidential by the person supplying it may be disclosed because it is not a trade secret or commercial or financial information which is obtained from any person and which is privileged or confidential, within the meaning of section 6(f) [15 USCS § 46(f)], then the Commission shall notify such person in writing that the Commission intends to disclose the document at a date not less than 10 days after the date of receipt of notification.

(3) Any person receiving such notification may, if he believes disclosure of the document would cause disclosure of a trade secret, or commercial or financial information which is obtained from any person and which is privileged or confidential, within the meaning of section 6(f) [15 USCS § 46(f)], before the date set for release of the document, bring an action in the district court of the United States for the district within which the documents are located or in the United States District Court for the District of Columbia to restrain disclosure of the document. Any person receiving such notification may file with the appropriate district court or court of appeals of the United States, as appropriate, an application for a stay of disclosure. The documents shall not be disclosed until the court has ruled on the application for a stay.

(d) Particular disclosures allowed.

(1) The provisions of subsection (c) shall not be construed to prohibit—

(A) the disclosure of information to either House of the Congress or to any committee or subcommittee of the Congress, except that the Commission immediately shall notify the owner or provider of any such information of a request for information designated as confidential by the owner or provider;

(B) the disclosure of the results of any investigation or study carried out or prepared by the Commission, except that no information shall be identified nor shall information be disclosed in such a manner as to disclose a trade secret of any person supplying the trade secret, or to disclose any commercial or financial information which is obtained from any person and which is privileged or confidential;

(C) the disclosure of relevant and material information in Commission adjudicative proceedings or in judicial proceedings to which the Commission is a party; or

(D) the disclosure to a Federal agency of disaggregated information obtained in accordance with section 3512 of title 44, United States Code, except that the recipient agency shall use such disaggregated information for economic, statistical, or policymaking purposes only, and shall not disclose such information in an individually identifiable form.

(2) Any disclosure of relevant and material information in Commission adjudicative proceedings or in judicial proceedings to which the Commission is a party shall be governed by the rules of the Commission for adjudicative proceedings or by court rules or orders, except that the rules of the Commission shall not be amended in a manner inconsistent with the purposes of this section.

(e) Effect on other statutory provisions limiting disclosure. Nothing in this section shall supersede any statutory provision which expressly prohibits or limits particular disclosures by the Commission, or which authorizes disclosures to any other Federal agency.

(f) Exemption from disclosure. Any material which is received by the Commission in any investigation, a purpose of which is to determine whether any person may have violated any provision of the laws administered by the Commission, and which is provided pursuant to any compulsory process under this Act or which is provided voluntarily in place of such compulsory process shall be exempt from disclosure under section 552 of title 5, United States Code.

## Federal Food, Drug, And Cosmetic Act

### Title 21. Food and Drugs

#### Chapter 9. Federal Food, Drug, And Cosmetic Act Definitions

##### § 331. Prohibited acts

The following acts and the causing thereof are hereby prohibited:

(a) The introduction or delivery for introduction into interstate commerce of any food, drug, device, or cosmetic that is adulterated or misbranded.

(b) The adulteration or misbranding of any food, drug, device, or cosmetic in interstate commerce.

(c) The receipt in interstate commerce of any food, drug, device, or cosmetic that is adulterated or misbranded, and the delivery or proffered delivery thereof for pay or otherwise.

(d) The introduction or delivery for introduction into interstate commerce of any article in violation of section 404 or 505 [21 USCS § 344 or 355].

(e) The refusal to permit access to or copying of any record as required by section 412, 414, 504, 703, or 704(a) [21 USCS § 350a, 350c, 354, 373, or 374(a)]; or the failure to establish or maintain any record, or make any report, required under section 412, 414(b), 504, 505(i) or (k), 512(a)(4)(C), 512(j), (l), or (m), 515(f), or 519 [21 USCS § 350a, 350c(b), 354, 355(i) or (k), 360b(a)(4)(C), 360b(j), (l), or (m) 360e(f), or 360i] or the refusal to permit access to or verification or copying of any such required record.

(f) The refusal to permit entry or inspection as authorized by section 704 [21 USCS § 374].

(g) The manufacture, within any Territory of any food, drug, device, or cosmetic that is adulterated or misbranded.

(h) The giving of a guaranty or undertaking referred to in section 303(c)(2) [21 USCS § 333(c)(2)], which guaranty or undertaking is false, except by a person who relied upon a guaranty or undertaking to the same effect signed by, containing the name and address of, the person residing in the United States from whom he received in good faith the food, drug, device, or cosmetic; or the giving of a guaranty or undertaking referred to in section 303(c)(3) [21 USCS § 333(c)(3)], which guaranty or undertaking is false.

(i) (1) Forging, counterfeiting, simulating, or falsely representing, or without proper authority using any mark, stamp, tag, label, or other identification device authorized or required by regulations promulgated under the provisions of section 404 or 721 [21 USCS § 344 or 379e].

(2) Making, selling, disposing of, or keeping in possession, control, or custody, or concealing any punch, die, plate, stone, or other thing designed to print, imprint, or reproduce the trademark, trade name, or other identifying mark, imprint, or device of another or any likeness of any of the foregoing upon any drug or container or labeling thereof so as to render such drug a counterfeit drug.

(3) The doing of any act which causes a drug to be a counterfeit drug, or the sale or dispensing, or the holding for sale or dispensing, of a counterfeit drug.

(j) The using by any person to his own advantage or revealing, other than to the Secretary or officers or employees of the Department, or to the courts when relevant in any judicial proceeding under this Act [21 USCS §§ 301 et seq.], any information acquired under authority of section 404, 409, 412, 414, 505, 510, 512, 513, 514, 515, 516, 518, 519, 520, 704, 708 or 721 [21 USCS § 344, 348, 350a, 350c, 355, 360, 360b, 360c, 360d, 360e, 360f, 360h, 360i, 360j, 374, 379, or 379e], concerning any method or process which as a trade secret is entitled to protection; or the violating of section 408(i)(2) [21 USCS § 346a(i)(2)] or any regulation issued under that section.[.] This paragraph does not authorize the withholding of information from either House of Congress or from, to the extent of matter within its jurisdiction, any committee or subcommittee of such committee or any joint committee of Congress or any subcommittee of such joint committee.

(k) The alteration, mutilation, destruction, obliteration, or removal of the whole or any part of the labeling of, or the doing of any other act with respect to, a food, drug, device, or cosmetic, if such act is done while such article is held for sale (whether or not the first sale) after shipment in interstate commerce and results in such article being adulterated or misbranded.

(l) [Deleted]

(m) The sale or offering for sale of colored oleomargarine or colored margarine, or the possession or serving of colored oleomargarine or

colored margarine in violation of sections 407(b), or 407(c) [21 USCS § 347(b) or (c)].

(n) The using, in labeling, advertising or other sales promotion of any reference to any report or analysis furnished in compliance with section 704 [21 USCS § 374].

(o) In the case of a prescription drug distributed or offered for sale in interstate commerce, the failure of the manufacturer, packer, or distributor thereof to maintain for transmittal, or to transmit, to any practitioner licensed by applicable State law to administer such drug who makes written request for information as to such drug, true and correct copies of all printed matter which is required to be included in any package in which that drug is distributed or sold, or such other printed matter as is approved by the Secretary. Nothing in this paragraph shall be construed to exempt any person from any labeling requirement imposed by or under other provisions of this Act [21 USCS §§ 301 et seq.].

(p) The failure to register in accordance with section 510 [21 USCS § 360], the failure to provide any information required by section 510(j) or 510k, [21 USCS § 360(j) or (k)], or the failure to provide a notice required by section 510(j)(2) [21 USCS 360(j)(2)].

(q) (1) The failure or refusal to (A) comply with any requirement prescribed under section 518 or 520(g) [21 USCS § 360h or 360(j)(g)], (B) furnish any notification or other material or information required by or under section 519 or 520(g) [21 USCS § 360i or 360(j)(g)], or (C) comply with a requirement under section 522 [21 USCS § 360l].

(2) With respect to any device, the submission of any report that is required by or under this Act [21 USCS §§ 301 et seq.] that is false or misleading in any material respect.

(r) The movement of a device in violation of an order under section 304(g) [21 USCS § 334(g)] or the removal or alteration of any mark or label required by the order to identify the device as detained.

(s) The failure to provide the notice required by section 412(c) or 412(e) [21 USCS § 350a(c) or (e)], the failure to make the reports required by section 412(f)(1)(B) [21 USCS § 350a(b)(1)(B)], the failure to retain the records required by section 412(b)(4) [21 USCS § 350a(b)(4)], or the failure to meet the requirements prescribed under section 412(f)(3) [21 USCS § 350a(f)(3)].

(t) The importation of a drug in violation of section 801(d)(1) [21 USCS § 381(d)(1)], the sale, purchase, or trade of a drug or drug sample or the offer to sell, purchase, or trade a drug or drug sample in violation of section 503(c) [21 USCS § 353(c)], the sale, purchase, or trade of a coupon, the offer to sell, purchase, or trade such a coupon, or the counterfeiting of such a coupon in violation of section 503(c)(2) [21 USCS § 353(c)(2)], the distribution of a drug sample in violation of section 503(d) [21 USCS § 353(d)], or the failure to otherwise comply with the requirements of section 503(d) [21 USCS § 353(d)], or the distribution of drugs in violation of section 503(e) [21 USCS § 353(e)] or the failure to otherwise comply with the requirements of section 503(e) [21 USCS § 353(e)].

(u) The failure to comply with any requirements of the provisions of, or any regulations or orders of the Secretary, under section 512(a)(4)(A), 512(a)(4)(D), or 512(a)(5) [21 USCS § 360b(a)(4)(A), (4)(D), or (5)].

(v) The introduction or delivery for introduction into interstate commerce of a dietary supplement that is unsafe under section 413 [21 USCS § 350b].

(w) The making of a knowingly false statement in any statement, certificate of analysis, record, or report required or requested under section 801(d)(3) [21 USCS § 381(d)(3)]; the failure to submit a certificate of analysis as required under such section; the failure to maintain records or to submit records or reports as required by such section; the release into interstate commerce of any article or portion thereof imported into the United States under such section or any finished product made from such article or portion, except for export in accordance with section 801(e) or 802 [21 USCS § 381(e) or 382], or with section 351(h) of the Public Health Service Act [42 USCS § 262(h)]; or the failure to so export or to destroy such an article or portions thereof, or such a finished product.

(x) The falsification of a declaration of conformity submitted under section 514(c) [21 USCS § 360d(c)] or the failure or refusal to provide data or information requested by the Secretary under paragraph (3) of such section.

(y) In the case of a drug, device, or food—

(1) the submission of a report or recommendation by a person ac-

credited under section 523 [21 USCS § 360m] that is false or misleading in any material respect;

(2) the disclosure by a person accredited under section 523 [21 USCS § 360m] of confidential commercial information or any trade secret without the express written consent of the person who submitted such information or secret to such person; or

(3) the receipt by a person accredited under section 523 [21 USCS § 360m] of a bribe in any form or the doing of any corrupt act by such person associated with a responsibility delegated to such person under this Act [21 USCS §§ 301 et seq.].

(z) The dissemination of information in violation of section 551 [21 USCS § 360aaa].

(aa) The importation of a covered product in violation of section 804 [21 USCS § 384], the falsification of any record required to be maintained or provided to the Secretary under such section, or any other violation of regulations under such section.

(bb) The transfer of an article of food in violation of an order under section 304(h) [21 USCS § 334(h)], or the removal or alteration of any mark or label required by the order to identify the article as detained.

(cc) The importing or offering for import into the United States of an article of food by, with the assistance of, or at the direction of, a person debarred under section 306(b)(3) [21 USCS § 335a(b)(3)].

(dd) The failure to register in accordance with section 415 [21 USCS § 350d].

(ee) The importing or offering for import into the United States of an article of food in violation of the requirements under section 801(m) [21 USCS § 381(m)].

(ff) The importing or offering for import into the United States of a drug or device with respect to which there is a failure to comply with a request of the Secretary to submit to the Secretary a statement under section 801(o) [21 USCS § 381(o)].

(gg) The knowing failure of a person accredited under paragraph (2) of section 704(g) [21 USCS § 374(g)] to comply with paragraph (7)(E) of such section; the knowing inclusion by such a person of false information in an inspection report under paragraph (7)(A) of such section; or the knowing failure of such a person to include material facts in such a report.

§ 332. Injunction proceedings

(a) Jurisdiction of courts. The district courts of the United States and the United States courts of the Territories shall have jurisdiction, for cause shown to restrain violations of section 301 [21 USCS § 331], except paragraphs (h), (i), and (j).

(b) Violation of injunction. In case of violation of an injunction or restraining order issued under this section, which also constitutes a violation of this Act, trial shall be by the court, or, upon demand of the accused, by a jury.

§ 333. Penalties

(a) Violation of 21 USCS § 331.

(1) Any person who violates a provision of section 301 [21 USCS § 331] shall be imprisoned for not more than one year or fined not more than \$ 1,000, or both.

(2) Notwithstanding the provisions of paragraph (1) of this section, if any person commits such a violation after a conviction of him under this section has become final, or commits such a violation with the intent to defraud or mislead, such person shall be imprisoned for not more than three years or fined not more than \$ 10,000 or both.

(b) Imprisonment and fines.

(1) Notwithstanding subsection (a), any person who violates section 301(t) [21 USCS § 331(t)] by—

(A) knowingly importing a drug in violation of section 801(d)(1) [21 USCS § 381(d)(1)],

(B) knowingly selling, purchasing, or trading a drug or drug sample or knowingly offering to sell, purchase, or trade a drug or drug sample, in violation of section 503(c)(1) [21 USCS § 353(c)(1)],

(C) knowingly selling, purchasing, or trading a coupon, knowingly offering to sell, purchase, or trade such a coupon, or knowingly counterfeiting such a coupon, in violation of section 503(c)(2) [21 USCS § 353(c)(2)], or

(D) knowingly distributing drugs in violation of section 503(e)(2)(A) [21 USCS § 353(e)(2)(A)], shall be imprisoned for not more than 10 years or fined not more than \$ 250,000, or both.

(2) Any manufacturer or distributor who distributes drug samples by means other than the mail or common carrier whose representative, during the course of the representative's employment or association

with that manufacturer or distributor, violated section 301(t) [21 USCS § 331(t)] because of a violation of section 503(c)(1) [21 USCS § 353(c)(1)] or violated any State law prohibiting the sale, purchase, or trade of a drug sample subject to section 503(b) [21 USCS § 353(b)] or the offer to sell, purchase, or trade such a drug sample shall, upon conviction of the representative for such violation, be subject to the following civil penalties:

(A) A civil penalty of not more than \$ 50,000 for each of the first two such violations resulting in a conviction of any representative of the manufacturer or distributor in any 10-year period.

(B) A civil penalty of not more than \$ 1,000,000 for each violation resulting in a conviction of any representative after the second conviction in any 10-year period. For the purposes of this paragraph, multiple convictions of one or more persons arising out of the same event or transaction, or a related series of events or transactions, shall be considered as one violation.

(3) Any manufacturer or distributor who violates section 301(t) [21 USCS § 331(t)] because of a failure to make a report required by section 503(d)(3)(E) [21 USCS § 353(d)(3)(E)] shall be subject to a civil penalty of not more than \$ 100,000.

(4) (A) If a manufacturer or distributor or any representative of such manufacturer or distributor provides information leading to the institution of a criminal proceeding against, and conviction of, any representative of that manufacturer or distributor for a violation of section 301(t) [21 USCS § 331(t)] because of a sale, purchase, or trade or offer to purchase, sell, or trade a drug sample in violation of section 503(c)(1) [21 USCS § 353(c)(1)] or for a violation of State law prohibiting the sale, purchase, or trade or offer to sell, purchase, or trade a drug sample, the conviction of such representative shall not be considered as a violation for purposes of paragraph (2).

(B) If, in an action brought under paragraph (2) against a manufacturer or distributor relating to the conviction of a representative of such manufacturer or distributor for the sale, purchase, or trade of a drug or the offer to sell, purchase, or trade a drug, it is shown, by clear and convincing evidence—

(i) that the manufacturer or distributor conducted, before the institution of a criminal proceeding against such representative for the violation which resulted in such conviction, an investigation of events or transactions which would have led to the reporting of information leading to the institution of a criminal proceeding against, and conviction of, such representative for such purchase, sale, or trade or offer to purchase, sell, or trade, or

(ii) that, except in the case of the conviction of a representative employed in a supervisory function, despite diligent implementation by the manufacturer or distributor of an independent audit and security system designed to detect such a violation, the manufacturer or distributor could not reasonably have been expected to have detected such violation,

the conviction of such representative shall not be considered as a conviction for purposes of paragraph (2).

(5) If a person provides information leading to the institution of a criminal proceeding against, and conviction of, a person for a violation of section 301(t) [21 USCS § 331(t)] because of the sale, purchase, or trade of a drug sample or the offer to sell, purchase, or trade a drug sample in violation of section 503(c)(1) [21 USCS § 353(c)(1)], such person shall be entitled to one-half of the criminal fine imposed and collected for such violation but not more than \$ 125,000.

(6) Notwithstanding subsection (a), any person who is a manufacturer or importer of a covered product pursuant to section 804(a) [21 USCS § 384(a)] and knowingly fails to comply with a requirement of section 804(e) [21 USCS § 384(e)] that is applicable to such manufacturer or importer, respectively, shall be imprisoned for not more than 10 years or fined not more than \$ 250,000, or both.

(c) Exceptions in certain cases of good faith, etc. No person shall be subject to the penalties of subsection (a)(1) of this section, (1) for having received in interstate commerce any article and delivered it or proffered delivery of it, if such delivery or proffer was made in good faith, unless he refuses to furnish on request of an officer or employee duly designated by the Secretary the name and address of the person from whom he purchased or received such article and copies of all documents, if any there be, pertaining to the delivery of the article to him; or (2) for having violated section 301(a) or (d) [21 USCS § 331(a), (d)], if he establishes a guaranty or undertaking signed by, and containing the name and address of, the person residing in the United States from

whom he received in good faith the article, to the effect, in case of an alleged violation of section 301(a) [21 USCS § 331(a)], that such article is not adulterated or misbranded, within the meaning of this Act, designating this Act, or to the effect, in case of an alleged violation of section 301(d) [21 USCS § 331(d)], that such article is not an article which may not, under the provisions of section 404 or 505 [21 USCS § 344 or 355], be introduced into interstate commerce; or (3) for having violated section 301(a) [21 USCS § 331(a)], where the violation exists because the article is adulterated by reason of containing a color additive not from a batch certified in accordance with regulations promulgated by the Secretary, under this Act, if such person establishes a guaranty or undertaking signed by, and containing the name and address of, the manufacturer of the color additive, to the effect that such color additive was from a batch certified in accordance with the applicable regulations promulgated by the Secretary under this Act; or (4) for having violated section 301(b), (c) or (k) [21 USCS § 331(b), (c) or (k)] by failure to comply with section 502(f) [21 USCS § 352(f)] in respect to an article received in interstate commerce to which neither section 503(a) [21 USCS § 353(a)] nor section 503(b)(1) [21 USCS § 353(b)(1)] is applicable, if the delivery or proffered delivery was made in good faith and the labeling at the time thereof contained the same directions for use and warning statements as were contained in the labeling at the time of such receipt of such article; or (5) for having violated section 301(i)(2) [21 USCS § 331(i)(2)] if such person acted in good faith and had no reason to believe that use of the punch, die, plate, stone, or other thing involved would result in a drug being a counterfeit drug, or for having violated section 301(i)(3) [21 USCS § 331(i)(3)] if the person doing the act or causing it to be done acted in good faith and had no reason to believe that the drug was a counterfeit drug.

(d) Exceptions involving misbranded food. No person shall be subject to the penalties of subsection (a)(1) of this section for a violation of section 301 [21 USCS § 331] involving misbranded food if the violation exists solely because the food is misbranded under section 403(a)(2) [21 USCS § 343(a)(2)] because of its advertising.

(e) Distribution of or possession with intent to distribute human growth hormone; exception.

(1) Except as provided in paragraph (2), whoever knowingly distributes, or possesses with intent to distribute, human growth hormone for any use in humans other than the treatment of a disease or other recognized medical condition, where such use has been authorized by the Secretary of Health and Human Services under section 505 [21 USCS § 355] and pursuant to the order of a physician, is guilty of an offense punishable by not more than 5 years in prison, such fines as are authorized by title 18, United States Code, or both.

(2) Whoever commits any offense set forth in paragraph (1) and such offense involves an individual under 18 years of age is punishable by not more than 10 years imprisonment, such fines as are authorized by title 18, United States Code, or both.

(3) Any conviction for a violation of paragraphs (1) and (2) of this subsection shall be considered a felony violation of the Controlled Substances Act for the purposes of forfeiture under section 413 of such Act [21 USCS § 853].

(4) As used in this subsection the term “human growth hormone” means somatrem, somatotropin, or an analogue of either of them.

(5) The Drug Enforcement Administration is authorized to investigate offenses punishable by this subsection.

(f) Civil penalties.

(1) (A) Except as provided in subparagraph (B), any person who violates a requirement of this Act which relates to devices shall be liable to the United States for a civil penalty in an amount not to exceed \$ 15,000 for each such violation, and not to exceed \$ 1,000,000 for all such violations adjudicated in a single proceeding. For purposes of the preceding sentence, a person accredited under paragraph (2) of section 704(g) [21 USCS § 374(g)] who is substantially not in compliance with the standards of accreditation under such section, or who poses a threat to public health or fails to act in a manner that is consistent with the purposes of such section, shall be considered to have violated a requirement of this Act that relates to devices.

(B) Subparagraph (A) shall not apply—

(i) to any person who violates the requirements of section 519(a) or 520(f) [21 USCS § 360i(a) or § 360j(f)] unless such violation constitutes (I) a significant or knowing departure from such requirements, or (II) a risk to public health,

(ii) to any person who commits minor violations of section

519(e) or 519(f) [21 USCS § 360i(e) or (f)] (only with respect to correction reports) if such person demonstrates substantial compliance with such section, or

(iii) to violations of section 501(a)(2)(A) [21 USCS § 360(a)(2)(A)] which involve one or more devices which are not defective.

(2) (A) Any person who introduces into interstate commerce or delivers for introduction into interstate commerce an article of food that is adulterated within the meaning of section 402(a)(2)(B) [21 USCS § 342(a)(2)(B)] shall be subject to a civil money penalty of not more than \$ 50,000 in the case of an individual and \$ 250,000 in the case of any other person for such introduction or delivery, not to exceed \$ 500,000 for all such violations adjudicated in a single proceeding.

(B) This paragraph shall not apply to any person who grew the article of food that is adulterated. If the Secretary assesses a civil penalty against any person under this paragraph, the Secretary may not use the criminal authorities under this section to sanction such person for the introduction or delivery for introduction into interstate commerce of the article of food that is adulterated. If the Secretary assesses a civil penalty against any person under this paragraph, the Secretary may not use the seizure authorities of section 304 [21 USCS § 334] or the injunction authorities of section 302 [21 USCS § 332] with respect to the article of food that is adulterated.

(C) In a hearing to assess a civil penalty under this paragraph, the presiding officer shall have the same authority with regard to compelling testimony or production of documents as a presiding officer has under section 408(g)(2)(B) [21 USCS § 346a(g)(2)(B)]. The third sentence of paragraph (3)(A) shall not apply to any investigation under this paragraph.

(3) (A) A civil penalty under paragraph (1) or (2) shall be assessed by the Secretary by an order made on the record after opportunity for a hearing provided in accordance with this subparagraph and section 554 of title 5, United States Code. Before issuing such an order, the Secretary shall give written notice to the person to be assessed a civil penalty under such order of the Secretary's proposal to issue such order and provide such person an opportunity for a hearing on the order. In the course of any investigation, the Secretary may issue subpoenas requiring the attendance and testimony of witnesses and the production of evidence that relates to the matter under investigation.

(B) In determining the amount of a civil penalty, the Secretary shall take into account the nature, circumstances, extent, and gravity of the violation or violations and, with respect to the violator, ability to pay, effect on ability to continue to do business, any history of prior such violations, the degree of culpability, and such other matters as justice may require.

(C) The Secretary may compromise, modify, or remit, with or without conditions, any civil penalty which may be assessed under paragraph (1) or (2). The amount of such penalty, when finally determined, or the amount agreed upon in compromise, may be deducted from any sums owing by the United States to the person charged.

(4) Any person who requested, in accordance with paragraph (3)(A), a hearing respecting the assessment of a civil penalty and who is aggrieved by an order assessing a civil penalty may file a petition for judicial review of such order with the United States Court of Appeals for the District of Columbia Circuit or for any other circuit in which such person resides or transacts business. Such a petition may only be filed within the 60-day period beginning on the date the order making such assessment was issued.

(5) If any person fails to pay an assessment of a civil penalty—

(A) after the order making the assessment becomes final, and if such person does not file a petition for judicial review of the order in accordance with paragraph (4), or

(B) after a court in an action brought under paragraph (4) has entered a final judgment in favor of the Secretary, the Attorney General shall recover the amount assessed (plus interest at currently prevailing rates from the date of the expiration of the 60-day period referred to in paragraph (4) or the date of such final judgment, as the case may be) in an action brought in any appropriate district court of the United States. In such an action, the validity, amount, and appropriateness of such penalty shall not be subject to review.

§ 334. Seizure

(a) Grounds and jurisdiction.

(1) Any article of food, drug, or cosmetic that is adulterated or misbranded when introduced into or while in interstate commerce or while held for sale (whether or not the first sale) after shipment in interstate

commerce, or which may not, under the provisions of section 404 or 505 [21 USCS § 344 or 355], be introduced into interstate commerce, shall be liable to be proceeded against while in interstate commerce, or at any time thereafter, on libel of information and condemned in any district court of the United States or United States court of a Territory within the jurisdiction of which the article is found. No libel for condemnation shall be instituted under this Act [21 USCS §§ 301 et seq.], for any alleged misbranding if there is pending in any court a libel for condemnation proceeding under this Act [21 USCS §§ 301 et seq.] based upon the same alleged misbranding, and not more than one such proceeding shall be instituted if no such proceeding is so pending, except that such limitations shall not apply (A) when such misbranding has been the basis of a prior judgment in favor of the United States, in a criminal, injunction, or libel for condemnation proceeding under this Act [21 USCS §§ 301 et seq.], or (B) when the Secretary has probable cause to believe from facts found, without hearing, by him or any officer or employee of the Department that the misbranded article is dangerous to health, or that the labeling of the misbranded article is fraudulent, or would be in a material respect misleading to the injury or damage of the purchaser or consumer. In any case where the number of libel for condemnation proceedings is limited as above provided the proceeding pending or instituted shall, on application of the claimant, seasonably made, be removed for trial to any district agreed upon by stipulation between the parties, or, in case of failure to so stipulate within a reasonable time, the claimant may apply to the court of the district in which the seizure has been made, and such court (after giving the United States attorney for such district reasonable notice and opportunity to be heard) shall by order, unless good cause to the contrary is shown, specify a district of reasonable proximity to the claimant's principal place of business, to which the case shall be removed for trial.

(2) The following shall be liable to be proceeded against at any time on libel of information and condemned in any district court of the United States or United States court of a Territory within the jurisdiction of which they are found: (A) Any drug that is a counterfeit drug, (B) Any container of a counterfeit drug, (C) Any punch, die, plate, stone, labeling, container, or other thing used or designed for use in making a counterfeit drug or drugs, and (D) Any adulterated or misbranded device.

(3) (A) Except as provided in subparagraph (B), no libel for condemnation may be instituted under paragraph (1) or (2) against any food which—

(i) is misbranded under section 403(a)(2) [21 USCS § 343(a)(2)] because of its advertising, and

(ii) is being held for sale to the ultimate consumer in an establishment other than an establishment owned or operated by a manufacturer, packer, or distributor of the food.

(B) A libel for condemnation may be instituted under paragraph (1) or (2) against a food described in subparagraph (A) if—

(i) (I) the food's advertising which resulted in the food being misbranded under section 403(a)(2) [21 USCS § 343(a)(2)] was disseminated in the establishment in which the food is being held for sale to the ultimate consumer,

(II) such advertising was disseminated by, or under the direction of, the owner or operator of such establishment, or

(III) all or part of the cost of such advertising was paid by such owner or operator; and

(ii) the owner or operator of such establishment used such advertising in the establishment to promote the sale of the food. (b) Procedure; multiplicity of pending proceedings. The article, equipment, or other thing proceeded against shall be liable to seizure by process pursuant to the libel, and the procedure in cases under this section shall conform, as nearly as may be, to the procedure in admiralty; except that on demand of either party any issue of fact joined in any such case shall be tried by jury. When libel for condemnation proceedings under this section, involving the same claimant and the same issues of adulteration or misbranding, are pending in two or more jurisdictions, such pending proceedings, upon application of the claimant seasonably made to the court of one such jurisdiction, shall be consolidated for trial by order of such court, and tried in (1) any district selected by the claimant where one of such proceedings is pending; or (2) a district agreed upon by stipulation between the parties. If no order for consolidation is so made within a reasonable time, the claimant may apply to the court of one such jurisdiction, and such court (after giving the United States attorney for such district reason-

able notice and opportunity to be heard) shall by order, unless good cause to the contrary is shown, specify a district of reasonable proximity to the claimant's principal place of business, in which all such pending proceedings shall be consolidated for trial and tried. Such order of consolidation shall not apply so as to require the removal of any case the date for trial of which has been fixed. The court granting such order shall give prompt notification thereof to the other courts having jurisdiction of the cases covered thereby.

(c) Availability of samples of seized goods prior to trial. The court at any time after seizure up to a reasonable time before trial shall by order allow any party to a condemnation proceeding, his attorney or agent, to obtain a representative sample of the article seized and a true copy of the analysis, if any, on which the proceeding is based and the identifying marks or numbers, if any, of the packages from which the samples analyzed were obtained.

(d) Disposition of goods after decree of condemnation; claims for remission or mitigation of forfeitures.

(1) Any food, drug, device, or cosmetic condemned under this section shall, after entry of the decree, be disposed of by destruction or sale as the court may, in accordance with the provisions of this section, direct and the proceeds thereof, if sold, less the legal costs and charges, shall be paid into the Treasury of the United States; but such article shall not be sold under such decree contrary to the provisions of this Act [21 USCS §§ 301 et seq.] or the laws of the jurisdiction in which sold. After entry of the decree and upon the payment of the costs of such proceedings and the execution of a good and sufficient bond conditioned that such article shall not be sold or disposed of contrary to the provisions of this Act [21 USCS §§ 301 et seq.] or the laws of any State or Territory in which sold, the court may by order direct that such article be delivered to the owner thereof to be destroyed or brought into compliance with the provisions of this Act [21 USCS §§ 301 et seq.] under the supervision of an officer or employee duly designated by the Secretary, and the expenses of such supervision shall be paid by the person obtaining release of the article under bond. If the article was imported into the United States and the person seeking its release establishes (A) that the adulteration, misbranding, or violation did not occur after the article was imported, and (B) that he had no cause for believing that it was adulterated, misbranded, or in violation before it was released from customs custody, the court may permit the article to be delivered to the owner for exportation in lieu of destruction upon a showing by the owner that all of the conditions of section 801(e) [21 USCS § 381(e)] can and will be met. The provisions of this sentence shall not apply where condemnation is based upon violation of section 402(a)(1), (2), or (6) [21 USCS § 342(a)(1), (2), or (6)], section 501(a)(3) [21 USCS § 351(a)(3)], section 502(j) [21 USCS § 352(j)], or section 601(a) or (d) [21 USCS § 361(a) or (d)]. Where such exportation is made to the original foreign supplier, then subparagraphs (A) and (B) of section 801(e)(1) [21 USCS § 381(e)(1)(A), (B)] and the preceding sentence shall not be applicable; and in all cases of exportation the bond shall be conditioned that the article shall not be sold or disposed of until the applicable conditions of section 801(e) [21 USCS § 381(e)] have been met. Any person seeking to export an imported article pursuant to any of the provisions of this subsection shall establish that the article was intended for export at the time the article entered commerce. Any article condemned by reason of its being an article which may not, under section 404 or 505 [21 USCS § 344 or 355] be introduced into interest to commerce, shall be disposed of by destruction.

(2) The provisions of paragraph (1) of this subsection shall, to the extent deemed appropriate by the court, apply to any equipment or other thing which is not otherwise within the scope of such paragraph and which is referred to in paragraph (2) of subsection (a).

(3) Whenever in any proceeding under this section, involving paragraph (2) of subsection (a), the condemnation of any equipment or thing (other than a drug) is decreed, the court shall allow the claim of any claimant, to the extent of such claimant's interest, for remission or mitigation of such forfeiture if such claimant proves to the satisfaction of the court (i) that he has not committed or caused to be committed any prohibited act referred to in such paragraph (2) and has no interest in any drug referred to therein, (ii) that he has an interest in such equipment or other thing as owner or lienor or otherwise, acquired by him in good faith, and (iii) that he at no time had any knowledge or reason to believe that such equipment or other thing was being or would be used in, or to facilitate, the violation of laws of the United States relating to counterfeit drugs.

(e) Costs. When a decree of condemnation is entered against the article, court costs and fees, and storage and other proper expenses, shall be awarded against the person, if any, intervening as claimant of the article.

(f) Removal of case for trial. In the case of removal for trial of any case as provided by subsection (a) or (b)—

(1) The clerk of the court from which removal is made shall promptly transmit to the court in which the case is to be tried all records in the case necessary in order that such court may exercise jurisdiction.

(2) The court to which such case was removed shall have the powers and be subject to the duties, for purposes of such case, which the court from which removal was made would have had, or to which such court would have been subject, if such case had not been removed.

(g) Administrative restraint; detention orders.

(1) If during an inspection conducted under section 704 [21 USCS § 374] of a facility or a vehicle, a device which the officer or employee making the inspection has reason to believe is adulterated or misbranded is found in such facility or vehicle, such officer or employee may order the device detained (in accordance with regulations prescribed by the Secretary) for a reasonable period which may not exceed twenty days unless the Secretary determines that a period of detention greater than twenty days is required to institute an action under subsection (a) or section 302 [21 USCS § 332], in which case he may authorize a detention period of not to exceed thirty days. Regulations of the Secretary prescribed under this paragraph shall require that before a device may be ordered detained under this paragraph the Secretary or an officer or employee designated by the Secretary approve such order. A detention order under this paragraph may require the labeling or marking of a device during the period of its detention for the purpose of identifying the device as detained. Any person who would be entitled to claim a device if it were seized under subsection (a) may appeal to the Secretary a detention of such device under this paragraph. Within five days of the date an appeal of a detention is filed with the Secretary, the Secretary shall after affording opportunity for an informal hearing by order confirm the detention or revoke it.

(2) (A) Except as authorized by subparagraph (B), a device subject to a detention order issued under paragraph (1) shall not be moved by any person from the place at which it is ordered detained until—

(i) released by the Secretary, or

(ii) the expiration of the detention period applicable to such order, whichever occurs first.

(B) A device subject to a detention order under paragraph (1) may be moved—

(i) in accordance with regulations prescribed by the Secretary, and

(ii) if not in final form for shipment, at the discretion of the manufacturer of the device for the purpose of completing the work required to put it in such form.

(h) Administrative detention of foods.

(1) Detention authority

(A) In general. An officer or qualified employee of the Food and Drug Administration may order the detention, in accordance with this subsection, of any article of food that is found during an inspection, examination, or investigation under this Act [21 USCS §§ 301 et seq.] conducted by such officer or qualified employee, if the officer or qualified employee has credible evidence or information indicating that such article presents a threat of serious adverse health consequences or death to humans or animals.

(B) Secretary's approval. An article of food may be ordered detained under subparagraph (A) only if the Secretary or an official designated by the Secretary approves the order. An official may not be so designated unless the official is the director of the district under this Act [21 USCS §§ 301 et seq.] in which the article involved is located, or is an official senior to such director

(2) Period of detention. An article of food may be detained under paragraph (1) for a reasonable period, not to exceed 20 days, unless a greater period, not to exceed 30 days, is necessary, to enable the Secretary to institute an action under subsection (a) or section 302 [21 USCS § 332]. The Secretary shall by regulation provide for procedures for instituting such action on an expedited basis with respect to perishable foods.

(3) Security of detained article. An order under paragraph (1) with respect to an article of food may require that such article be labeled or

marked as detained, and shall require that the article be removed to a secure facility, as appropriate. An article subject to such an order shall not be transferred by any person from the place at which the article is ordered detained, or from the place to which the article is so removed, as the case may be, until released by the Secretary or until the expiration of the detention period applicable under such order, whichever occurs first. This subsection may not be construed as authorizing the delivery of the article pursuant to the execution of a bond while the article is subject to the order, and section 801(b) [21 USCS § 381(b)] does not authorize the delivery of the article pursuant to the execution of a bond while the article is subject to the order.

(4) Appeal of detention order.

(A) In general. With respect to an article of food ordered detained under paragraph (1), any person who would be entitled to be a claimant for such article if the article were seized under subsection (a) may appeal the order to the Secretary. Within five days after such an appeal is filed, the Secretary, after providing opportunity for an informal hearing, shall confirm or terminate the order involved, and such confirmation by the Secretary shall be considered a final agency action for purposes of section 702 of title 5, United States Code. If during such five-day period the Secretary fails to provide such an opportunity, or to confirm or terminate such order, the order is deemed to be terminated.

(B) Effect of instituting court action. The process under subparagraph (A) for the appeal of an order under paragraph (1) terminates if the Secretary institutes an action under subsection (a) or section 302 [21 USCS § 332] regarding the article of food involved.

§ 335b. Civil penalties

(a) In general. Any person that the Secretary finds—

(1) knowingly made or caused to be made, to any officer, employee, or agent of the Department of Health and Human Services, a false statement or misrepresentation of a material fact in connection with an abbreviated drug application,

(2) bribed or attempted to bribe or paid or attempted to pay an illegal gratuity to any officer, employee, or agent of the Department of Health and Human Services in connection with an abbreviated drug application,

(3) destroyed, altered, removed, or secreted, or procured the destruction, alteration, removal, or secretion of, any material document or other material evidence which was the property of or in the possession of the Department of Health and Human Services for the purpose of interfering with that Department's discharge of its responsibilities in connection with an abbreviated drug application,

(4) knowingly failed to disclose, to an officer or employee of the Department of Health and Human Services, a material fact which such person had an obligation to disclose relating to any drug subject to an abbreviated drug application,

(5) knowingly obstructed an investigation of the Department of Health and Human Services into any drug subject to an abbreviated drug application,

(6) is a person that has an approved or pending drug product application and has knowingly—

(A) employed or retained as a consultant or contractor, or

(B) otherwise used in any capacity the services of, a person who was debarred under section 306 [21 USCS § 335a], or

(7) is an individual debarred under section 306 [21 USCS § 335a] and, during the period of debarment, provided services in any capacity to a person that had an approved or pending drug product application, shall be liable to the United States for a civil penalty for each such violation in an amount not to exceed \$ 250,000 in the case of an individual and \$ 1,000,000 in the case of any other person.

(b) Procedure.

(1) In general.

(A) Action by the Secretary. A civil penalty under subsection (a) shall be assessed by the Secretary on a person by an order made on the record after an opportunity for an agency hearing on disputed issues of material fact and the amount of the penalty. In the course of any investigation or hearing under this subparagraph, the Secretary may administer oaths and affirmations, examine witnesses, receive evidence, and issue subpoenas requiring the attendance and testimony of witnesses and the production of evidence that relates to the matter under investigation.

(B) Action by the Attorney General. In lieu of a proceeding under subparagraph (A), the Attorney General may, upon request of the Secretary, institute a civil action to recover a civil money penalty in the

amount and for any of the acts set forth in subsection (a). Such an action may be instituted separately from or in connection with any other claim, civil or criminal, initiated by the Attorney General under this Act.

(2) Amount. In determining the amount of a civil penalty under paragraph (1), the Secretary or the court shall take into account the nature, circumstances, extent, and gravity of the act subject to penalty, the person's ability to pay, the effect on the person's ability to continue to do business, any history of prior, similar acts, and such other matters as justice may require.

(3) Limitation on actions. No action may be initiated under this section—

(A) with respect to any act described in subsection (a) that occurred before the date of the enactment of this section [enacted May 13, 1992], or

(B) more than 6 years after the date when facts material to the act are known or reasonably should have been known by the Secretary but in no event more than 10 years after the date the act took place.

(c) Judicial review. Any person that is the subject of an adverse decision under subsection (b)(1)(A) may obtain a review of such decision by the United States Court of Appeals for the District of Columbia or for the circuit in which the person resides, by filing in such court (within 60 days following the date the person is notified of the Secretary's decision) a petition requesting that the decision be modified or set aside.

(d) Recovery of penalties. The Attorney General may recover any civil penalty (plus interest at the currently prevailing rates from the date the penalty became final) assessed under subsection (b)(1)(A) in an action brought in the name of the United States. The amount of such penalty may be deducted, when the penalty has become final, from any sums then or later owing by the United States to the person against whom the penalty has been assessed. In an action brought under this subsection, the validity, amount, and appropriateness of the penalty shall not be subject to judicial review.

(e) Informants. The Secretary may award to any individual (other than an officer or employee of the Federal Government or a person who materially participated in any conduct described in subsection (a)) who provides information leading to the imposition of a civil penalty under this section an amount not to exceed—

(1) \$ 250,000, or

(2) one-half of the penalty so imposed and collected, whichever is less. The decision of the Secretary on such award shall not be reviewable.

§ 342. Adulterated food

A food shall be deemed to be adulterated—

(a) Poisonous, insanitary, or deleterious ingredients.

(1) If it bears or contains any poisonous or deleterious substance which may render it injurious to health; but in case the substance is not an added substance such food shall not be considered adulterated under this clause if the quantity of such substance in such food does not ordinarily render it injurious to health.; or (2)(A) if it bears or contains any added poisonous or added deleterious substance (other than a substance that is a pesticide chemical residue in or on a raw agricultural commodity or processed food, a food additive, a color additive, or a new animal drug) that is unsafe within the meaning of section 406 [21 USCS § 346]; or (B) if it bears or contains a pesticide chemical residue that is unsafe within the meaning of section 408(a) [21 USCS § 346a(a)]; or (C) if it is or if it bears or contains (i) any food additive that is unsafe within the meaning of section 409 [21 USCS § 348]; or (ii) a new animal drug (or conversion product thereof) that is unsafe within the meaning of section 512 [21 USCS § 360b]; or (3) if it consists in whole or in part of any filthy, putrid, or decomposed substances, or if it is otherwise unfit for food; or (4) if it has been prepared, packed, or held under insanitary conditions whereby it may have become contaminated with filth, or whereby it may have been rendered injurious to health; or (5) if it is, in whole or in part, the product of a diseased animal or of an animal which has died otherwise than by slaughter; or (6) if its container is composed, in whole or in part, of any poisonous or deleterious substance which may render the contents injurious to health; or (7) if it has been intentionally subjected to radiation, unless the use of the radiation was in conformity with a regulation or exemption in effect pursuant to section 409 [21 USCS § 348].

(b) Absence, substitution, or addition of constituents. (1) If any valuable constituent has been in whole or in part omitted or abstracted therefrom; or (2) if any substance has been substituted wholly or in

part thereof; or (3) if damage or inferiority has been concealed in any manner; or (4) if any substance has been added thereto or mixed or packed therewith so as to increase its bulk or weight, or reduce its quality or strength, or make it appear better or of greater value than it is. (c) Color additives. If it is, or it bears or contains, a color additive which is unsafe within the meaning of section 721(a) [21 USCS § 379e(a)].

(d) Confectionery containing alcohol or nonnutritive substance. If it is confectionery, and—

(1) has partially or completely imbedded therein any nonnutritive object, except that this subparagraph shall not apply in the case of any nonnutritive object if, in the judgment of the Secretary as provided by regulations, such object is of practical functional value to the confectionery product and would not render the product injurious or hazardous to health;

(2) bears or contains any alcohol other than alcohol not in excess of one-half of 1 per centum by volume derived solely from the use of flavoring extracts, except that this clause shall not apply to confectionery which is introduced or delivered for introduction into, or received or held for sale in, interstate commerce if the sale of such confectionery is permitted under the laws of the State in which such confectionery is intended to be offered for sale; or

(3) bears or contains any nonnutritive substance, except that this subparagraph shall not apply to a safe nonnutritive substance which is in or on confectionery by reason of its use for some practical functional purpose in the manufacture, packaging, or storage of such confectionery if the use of the substance does not promote deception of the consumer or otherwise result in adulteration or misbranding in violation of any provision of this Act [21 USCS §§ 301 et seq.], except that the Secretary may, for the purpose of avoiding or resolving uncertainty as to the application of this subparagraph, issue regulations allowing or prohibiting the use of particular nonnutritive substances.

(e) Oleomargarine containing filthy, putrid, etc., matter. If it is oleomargarine or margarine or butter and any of the raw material used therein consisted in whole or in part of any filthy, putrid, or decomposed substance, or such oleomargarine or margarine or butter is otherwise unfit for food.

(f) Safety of dietary supplements and burden of proof on FDA.

(1) If it is a dietary supplement or contains a dietary ingredient that—

(A) presents a significant or unreasonable risk of illness or injury under—

(i) conditions of use recommended or suggested in labeling, or

(ii) if no conditions of use are suggested or recommended in the labeling, under ordinary conditions of use;

(B) is a new dietary ingredient for which there is inadequate information to provide reasonable assurance that such ingredient does not present a significant or unreasonable risk of illness or injury;

(C) the Secretary declares to pose an imminent hazard to public health or safety, except that the authority to make such declaration shall not be delegated and the Secretary shall promptly after such a declaration initiate a proceeding in accordance with sections 554 and 556 of title 5, United States Code, to affirm or withdraw the declaration; or

(D) is or contains a dietary ingredient that renders it adulterated under paragraph (a)(1) under the conditions of use recommended or suggested in the labeling of such dietary supplement.

In any proceeding under this subparagraph, the United States shall bear the burden of proof on each element to show that a dietary supplement is adulterated. The court shall decide any issue under this paragraph on a de novo basis.

(2) Before the Secretary may report to a United States attorney a violation of paragraph (1)(A) for a civil proceeding, the person against whom such proceeding would be initiated shall be given appropriate notice and the opportunity to present views, orally and in writing, at least 10 days before such notice, with regard to such proceeding. (g) Good manufacturing practices.

(1) If it is a dietary supplement and it has been prepared, packed, or held under conditions that do not meet current good manufacturing practice regulations, including regulations requiring, when necessary, expiration date labeling, issued by the Secretary under subparagraph (2).

(2) The Secretary may by regulation prescribe good manufacturing practices for dietary supplements. Such regulations shall be modeled after current good manufacturing practice regulations for food and may

not impose standards for which there is no current and generally available analytical methodology. No standard of current good manufacturing practice may be imposed unless such standard is included in a regulation promulgated after notice and opportunity for comment in accordance with chapter 5 of title 5, United States Code [5 USCS §§ 500 et seq.].

(h) If it is an article of food imported or offered for import into the United States and the article of food has previously been refused admission under section 801(a) [21 USCS § 381(a)], unless the person offering the article affirmatively establishes, at the expense of the owner or consignee of the article, that the article complies with the applicable requirements of this Act [21 USCS §§ 301 et seq.], as determined by the Secretary.

§ 343. Misbranded food

A food shall be deemed to be misbranded—

(a) False or misleading label. If (1) its labeling is false or misleading in any particular, or (2) in the case of a food to which section 411 [21 USCS § 350] applies, its advertising is false or misleading in a material respect or its labeling is in violation of section 411(b)(2) [21 USCS § 350(b)(2)].

(b) Offer for sale under another name. If it is offered for sale under the name of another food.

(c) Imitation of another food. If it is an imitation of another food, unless its label bears, in type of uniform size and prominence, the word “imitation” and, immediately thereafter, the name of the food imitated.

(d) Misleading container. If its container is so made, formed, or filled as to be misleading.

(e) Package form. If in package form unless it bears a label containing (1) the name and place of business of the manufacturer, packer, or distributor; and (2) an accurate statement of the quantity of the contents in terms of weight, measure, or numerical count, except that under clause (2) of this paragraph reasonable variations shall be permitted, and exemptions as to small packages shall be established, by regulations prescribed by the Secretary.

(f) Prominence of information on label. If any word, statement, or other information required by or under authority of this Act [21 USCS §§ 301 et seq.] to appear on the label or labeling is not prominently placed thereon with such conspicuousness (as compared with other words, statements, designs, or devices, in the labeling) and in such terms as to render it likely to be read and understood by the ordinary individual under customary conditions of purchase and use.

(g) Representation as to definition and standard of identity. If it purports to be or is represented as a food for which a definition and standard of identity has been prescribed by regulations as provided by section 401 [21 USCS § 341], unless (1) it conforms to such definition and standard, and (2) its label bears the name of the food specified in the definition and standard, and, insofar as may be required by such regulations, the common names of optional ingredients (other than spices, flavoring, and coloring) present in such food.

(h) Representation as to standards of quality and fill of container. If it purports to be or is represented as—

(1) a food for which a standard of quality has been prescribed by regulations as provided by section 401 [21 USCS § 341], and its quality falls below such standard, unless its label bears, in such manner and form as such regulations specify, a statement that it falls below such standard;

(2) a food for which a standard or standards of fill of container have been prescribed by regulations as provided by section 401 [21 USCS § 341], and it falls below the standard of fill of container applicable thereto, unless its label bears, in such manner and form as such regulations specify, a statement that it falls below such standard; or

(3) a food that is pasteurized unless—

(A) such food has been subjected to a safe process or treatment that is prescribed as pasteurization for such food in a regulation promulgated under this Act [21 USCS §§ 301 et seq.]; or

(B) (i) such food has been subjected to a safe process or treatment that—

(I) is reasonably certain to achieve destruction or elimination in the food of the most resistant microorganisms of public health significance that are likely to occur in the food;

(II) is at least as protective of the public health as a process or treatment described in subparagraph (A);

(III) is effective for a period that is at least as long as the shelf life of the food when stored under normal and moderate abuse condi-

tions; and

(IV) is the subject of a notification to the Secretary, including effectiveness data regarding the process or treatment; and

(ii) at least 120 days have passed after the date of receipt of such notification by the Secretary without the Secretary making a determination that the process or treatment involved has not been shown to meet the requirements of subclauses (I) through (III) of clause (i). For purposes of paragraph (3), a determination by the Secretary that a process or treatment has not been shown to meet the requirements of subclauses (I) through (III) of subparagraph (B)(i) shall constitute final agency action under such subclauses.

(i) Label where no representation as to definition and standard of quality. Unless its label bears (1) the common or usual name of the food, if any there be, and (2) in case it is fabricated from two or more ingredients, the common or usual name of each such ingredient and if the food purports to be a beverage containing vegetable or fruit juice, a statement with appropriate prominence on the information panel of the total percentage of such fruit or vegetable juice contained in the food; except that spices, flavorings, and colors not required to be certified under section 721(c) [21 USCS § 379e(c)] unless sold as spices, flavorings, or such colors, may be designated as spices, flavorings, and colorings without naming each. To the extent that compliance with the requirements of clause (2) of this paragraph is impracticable, or results in deception or unfair competition, exemptions shall be established by regulations promulgated by the Secretary.

(j) Representation for special dietary use. If it purports to be or is represented for special dietary uses, unless its label bears such information concerning its vitamin, mineral, and other dietary properties as the Secretary determines to be, and by regulations prescribes as, necessary in order fully to inform purchasers as to its value for such uses.

(k) Artificial flavoring, artificial coloring, or chemical preservatives. If it bears or contains any artificial flavoring, artificial coloring, or chemical preservative, unless it bears labeling stating that fact, except that to the extent that compliance with the requirements of this paragraph is impracticable, exemptions shall be established by regulations promulgated by the Secretary. The provisions of this paragraph and paragraphs (g) and (i) with respect to artificial coloring shall not apply in the case of butter, cheese, or ice cream. The provisions of this paragraph with respect to chemical preservatives shall not apply to a pesticide chemical when used in or on a raw agricultural commodity which is the produce of the soil.

(l) Pesticide chemicals on raw agricultural commodities. If it is a raw agricultural commodity which is the produce of the soil, bearing or containing a pesticide chemical applied after harvest, unless the shipping container of such commodity bears labeling which declares the presence of such chemical in or on such commodity and the common or usual name and the function of such chemical, except that no such declaration shall be required while such commodity, having been removed from the shipping container, is being held or displayed for sale at retail out of such container in accordance with the custom of the trade.

(m) Color additives. If it is a color additive, unless its packaging and labeling are in conformity with such packaging and labeling requirements, applicable to such color additive, as may be contained in regulations issued under section 721 [21 USCS § 379e].

(n) Packaging or labeling of drugs in violation of regulations. If its packaging or labeling is in violation of an applicable regulation issued pursuant to section 3 or 4 of the Poison Prevention Packaging Act of 1970 [15 USCS § 1472 or 1473].

(o) [Repealed]

(p) [Deleted]

(q) Nutrition labeling; information required.

(1) Except as provided in subparagraphs (3), (4), and (5), if it is a food intended for human consumption and is offered for sale, unless its label or labeling bears nutrition information that provides—

(A) (i) the serving size which is an amount customarily consumed and which is expressed in a common household measure that is appropriate to the food, or

(ii) if the use of the food is not typically expressed in a serving size, the common household unit of measure that expresses the serving size of the food,

(B) the number of servings or other units of measure per container,

(C) the total number of calories—

(i) derived from any source, and

(ii) derived from the total fat, in each serving size or other unit of measure of the food,

(D) the amount of the following nutrients: Total fat, saturated fat, cholesterol, sodium, total carbohydrates, complex carbohydrates, sugars, dietary fiber, and total protein contained in each serving size or other unit of measure,

(E) any vitamin, mineral, or other nutrient required to be placed on the label and labeling of food under this Act [21 USCS §§ 301 et seq.] before October 1, 1990, if the Secretary determines that such information will assist consumers in maintaining healthy dietary practices.

The Secretary may by regulation require any information required to be placed on the label or labeling by this subparagraph or subparagraph (2)(A) to be highlighted on the label or labeling by larger type, bold type, or contrasting color if the Secretary determines that such highlighting will assist consumers in maintaining healthy dietary practices.

(2) (A) If the Secretary determines that a nutrient other than a nutrient required by subparagraph (1)(C), (1)(D), or (1)(E) should be included in the label or labeling of food subject to subparagraph (1) for purposes of providing information regarding the nutritional value of such food that will assist consumers in maintaining healthy dietary practices, the Secretary may by regulation require that information relating to such additional nutrient be included in the label or labeling of such food.

(B) If the Secretary determines that the information relating to a nutrient required by subparagraph (1)(C), (1)(D), or (1)(E) or clause (A) of this subparagraph to be included in the label or labeling of food is not necessary to assist consumers in maintaining healthy dietary practices, the Secretary may by regulation remove information relating to such nutrient from such requirement.

(3) For food that is received in bulk containers at a retail establishment, the Secretary may, by regulation, provide that the nutrition information required by subparagraphs (1) and (2) be displayed at the location in the retail establishment at which the food is offered for sale.

(4) (A) The Secretary shall provide for furnishing the nutrition information required by subparagraphs (1) and (2) with respect to raw agricultural commodities and raw fish by issuing voluntary nutrition guidelines, as provided by clause (B) or by issuing regulations that are mandatory as provided by clause (D).

(B) (i) Upon the expiration of 12 months after the date of the enactment of the Nutrition Labeling and Education Act of 1990 [enacted Nov. 8, 1990], the Secretary, after providing an opportunity for comment, shall issue guidelines for food retailers offering raw agricultural commodities or raw fish to provide nutrition information specified in subparagraphs (1) and (2). Such guidelines shall take into account the actions taken by food retailers during such 12-month period to provide to consumers nutrition information on raw agricultural commodities and raw fish. Such guidelines shall only apply—

(I) in the case of raw agricultural commodities, to the 20 varieties of vegetables most frequently consumed during a year and the 20 varieties of fruit most frequently consumed during a year, and

(II) to the 20 varieties of raw fish most frequently consumed during a year.

The vegetables, fruits, and raw fish to which such guidelines apply shall be determined by the Secretary by regulation and the Secretary may apply such guidelines regionally.

(ii) Upon the expiration of 12 months after the date of the enactment of the Nutrition Labeling and Education Act of 1990 [enacted Nov. 8, 1990], the Secretary shall issue a final regulation defining the circumstances that constitute substantial compliance by food retailers with the guidelines issued under subclause (i). The regulation shall provide that there is not substantial compliance if a significant number of retailers have failed to comply with the guidelines. The size of the retailers and the portion of the market served by retailers in compliance with the guidelines shall be considered in determining whether the substantial-compliance standard has been met.

(C) (i) Upon the expiration of 30 months after the date of the enactment of the Nutrition Labeling and Education Act of 1990 [enacted Nov. 8, 1990], the Secretary shall issue a report on actions taken by food retailers to provide consumers with nutrition information for raw agricultural commodities and raw fish under the guidelines issued under clause (A). Such report shall include a determination of whether



there is substantial compliance with the guidelines.

(ii) If the Secretary finds that there is substantial compliance with the guidelines, the Secretary shall issue a report and make a determination of the type required in subclause (i) every two years.

(D) (i) If the Secretary determines that there is not substantial compliance with the guidelines issued under clause (A), the Secretary shall at the time such determination is made issue proposed regulations requiring that any person who offers raw agricultural commodities or raw fish to consumers to provide, in a manner prescribed by regulations, the nutrition information required by subparagraphs (1) and (2). The Secretary shall issue final regulations imposing such requirements 6 months after issuing the proposed regulations. The final regulations shall become effective 6 months after the date of their promulgation.

(ii) Regulations issued under subclause (i) may require that the nutrition information required by subparagraphs (1) and (2) be provided for more than 20 varieties of vegetables, 20 varieties of fruit, and 20 varieties of fish most frequently consumed during a year if the Secretary finds that a larger number of such products are frequently consumed. Such regulations shall permit such information to be provided in a single location in each area in which raw agricultural commodities and raw fish are offered for sale. Such regulations may provide that information shall be expressed as an average or range per serving of the same type of raw agricultural commodity or raw fish. The Secretary shall develop and make available to the persons who offer such food to consumers the information required by subparagraphs (1) and (2).

(iii) Regulations issued under subclause (i) shall permit the required information to be provided in each area of an establishment in which raw agricultural commodities and raw Fish are offered for sale. The regulations shall permit food retailers to display the required information by supplying copies of the information provided by the Secretary, by making the information available in brochure, notebook or leaflet form, or by posting a sign disclosing the information. Such regulations shall also permit presentation of the required information to be supplemented by a video, live demonstration, or other media which the Secretary approves.

(E) For purposes of this subparagraph, the term "fish" includes freshwater or marine fin fish, crustaceans, and mollusks, including shellfish, amphibians, and other forms of aquatic animal life.

(F) No person who offers raw agricultural commodities or raw fish to consumers may be prosecuted for minor violations of this subparagraph if there has been substantial compliance with the requirements of this paragraph.

(5) (A) Subparagraphs (1), (2), (3), and (4) shall not apply to food—

(i) which is served in restaurants or other establishments in which food is served for immediate human consumption or which is sold for sale or use in such establishments,

(ii) which is processed and prepared primarily in a retail establishment, which is ready for human consumption, which is of the type described in subclause (i), and which is offered for sale to consumers but not for immediate human consumption in such establishment and which is not offered for sale outside such establishment,

(iii) which is an infant formula subject to section 412 [21 USCS § 350a],

(iv) which is a medical food as defined in section 5(b) of the Orphan Drug Act (21 U.S.C. 360ee(b)), or

(v) which is described in section 405(2) [21 USCS § 345(2)].

(B) Subparagraphs (1) and (2) shall not apply to the label of a food if the Secretary determines by regulations that compliance with such subparagraphs is impracticable because the package of such food is too small to comply with the requirements of such subparagraphs and if the label of such food does not contain any nutrition information.

(C) If a food contains insignificant amounts, as determined by the Secretary, of all the nutrients required by subparagraphs (1) and (2) to be listed in the label or labeling of food, the requirements of such subparagraphs shall not apply to such food if the label, labeling, or advertising of such food does not make any claim with respect to the nutritional value of such food. If a food contains insignificant amounts, as determined by the Secretary, of more than one-half the nutrients required by subparagraphs (1) and (2) to be in the label or labeling of the food, the Secretary shall require the amounts of such nutrients to be stated in a simplified form prescribed by the Secretary.

(D) If a person offers food for sale and has annual gross sales made or business done in sales to consumers which is not more than \$ 500,000 or has annual gross sales made or business done in sales of

food to consumers which is not more than \$ 50,000, the requirements of subparagraphs (1), (2), (3), and (4) shall not apply with respect to food sold by such person to consumers unless the label or labeling of food offered by such person provides nutrition information or makes a nutrition claim.

(E) (i) During the 12-month period for which an exemption from subparagraphs (1) and (2) is claimed pursuant to this subclause, the requirements of such subparagraphs shall not apply to any food product if—

(I) the labeling for such product does not provide nutrition information or make a claim subject to paragraph (r),

(II) the person who claims for such product an exemption from such subparagraphs employed fewer than an average of 100 full-time equivalent employees,

(III) such person provided the notice described in subclause (iii), and

(IV) in the case of a food product which was sold in the 12-month period preceding the period for which an exemption was claimed, fewer than 100,000 units of such product were sold in the United States during such preceding period, or in the case of a food product which was not sold in the 12-month period preceding the period for which such exemption is claimed, fewer than 100,000 units of such product are reasonably anticipated to be sold in the United States during the period for which such exemption is claimed.

(ii) During the 12-month period after the applicable date referred to in this sentence, the requirements of subparagraphs (1) and (2) shall not apply to any food product which was first introduced into interstate commerce before May 8, 1994, if the labeling for such product does not provide nutrition information or make a claim subject to paragraph (r), if such person provided the notice described in subclause (iii), and if—

(I) during the 12-month period preceding May 8, 1994, the person who claims for such product an exemption from such subparagraphs employed fewer than an average of 300 full-time equivalent employees and fewer than 600,000 units of such product were sold in the United States,

(II) during the 12-month period preceding May 8, 1995, the person who claims for such product an exemption from such subparagraphs employed fewer than an average of 300 full-time equivalent employees and fewer than 400,000 units of such product were sold in the United States, or

(III) during the 12-month period preceding May 8, 1996, the person who claims for such product an exemption from such subparagraphs employed fewer than an average of 200 full-time equivalent employees and fewer than 200,000 units of such product were sold in the United States.

(iii) The notice referred to in subclauses (i) and (ii) shall be given to the Secretary prior to the beginning of the period during which the exemption under subclause (i) or (ii) is to be in effect, shall state that the person claiming such exemption for a food product has complied with the applicable requirements of subclause (i) or (ii), and shall—

(I) state the average number of full-time equivalent employees such person employed during the 12 months preceding the date such person claims such exemption,

(II) state the approximate number of units the person claiming the exemption sold in the United States,

(III) if the exemption is claimed for a food product which was sold in the 12-month period preceding the period for which the exemption was claimed, state the approximate number of units of such product which were sold in the United States during such preceding period, and, if the exemption is claimed for a food product which was not sold in such preceding period, state the number of units of such product which such person reasonably anticipates will be sold in the United States during the period for which the exemption was claimed, and

(IV) contain such information as the Secretary may require to verify the information required by the preceding provisions of this subclause if the Secretary has questioned the validity of such information. If a person is not an importer, has fewer than 10 full-time equivalent employees, and sells fewer than 10,000 units of any food product in any year, such person is not required to file a notice for such product under this subclause for such year.

(iv) In the case of a person who claimed an exemption under subclause (i) or (ii), if, during the period of such exemption, the num-

ber of full-time equivalent employees of such person exceeds the number in such subclause or if the number of food products sold in the United States exceeds the number in such subclause, such exemption shall extend to the expiration of 18 months after the date the number of full-time equivalent employees or food products sold exceeded the applicable number

(v) For any food product first introduced into interstate commerce after May 8, 2002, the Secretary may by regulation lower the employee or units of food products requirement of subclause (i) if the Secretary determines that the cost of compliance with such lower requirement will not place an undue burden on persons subject to such lower requirement.

(vi) For purposes of subclauses (i), (ii), (iii), (iv), and (v)—

(I) the term “unit” means the packaging or, if there is no packaging, the form in which a food product is offered for sale to consumers,

(II) the term “food product” means food in any sized package which is manufactured by a single manufacturer or which bears the same brand name, which bears the same statement of identity, and which has similar preparation methods, and

(III) the term “person” in the case of a corporation includes all domestic and foreign affiliates of the corporation.

(F) A dietary supplement product (including a food to which section 411 [21 USCS § 350] applies) shall comply with the requirements of subparagraphs (1) and (2) in a manner which is appropriate for the product and which is specified in regulations of the Secretary which shall provide that—

(i) nutrition information shall first list those dietary ingredients that are present in the product in a significant amount and for which a recommendation for daily consumption has been established by the Secretary, except that a dietary ingredient shall not be required to be listed if it is not present in a significant amount, and shall list any other dietary ingredient present and identified as having no such recommendation;

(ii) the listing of dietary ingredients shall include the quantity of each such ingredient (or of a proprietary blend of such ingredients) per serving;

(iii) the listing of dietary ingredients may include the source of a dietary ingredient; and

(iv) the nutrition information shall immediately precede the ingredient information required under subclause (i), except that no ingredient identified pursuant to subclause (i) shall be required to be identified a second time.

(G) Subparagraphs (1), (2), (3), and (4) shall not apply to food which is sold by a food distributor if the food distributor principally sells food to restaurants or other establishments in which food is served for immediate human consumption and does not manufacture, process, or repack the food it sells.

(r) Labeling required.

(1) Except as provided in clauses (A) through (C) of subparagraph (5), if it is a food intended for human consumption which is offered for sale and for which a claim is made in the label or labeling of the food which expressly or by implication—

(A) characterizes the level of any nutrient which is of the type required by paragraph (q)(1) or (q)(2) to be in the label or labeling of the food unless the claim is made in accordance with subparagraph (2), or

(B) characterizes the relationship of any nutrient which is of the type required by paragraph (q)(1) or (q)(2) to be in the label or labeling of the food to a disease or a health-related condition unless the claim is made in accordance with subparagraph (3) or (5)(D).

A statement of the type required by paragraph (q) that appears as part of the nutrition information required or permitted by such paragraph is not a claim which is subject to this paragraph and a claim subject to clause (A) is not subject to clause (B).

(2) Except as provided in subparagraphs (4)(A)(ii) and (4)(A)(iii) and clauses (A) through (C) of subparagraph (5), a claim described in subparagraph (1)(A)—

(i) may be made only if the characterization of the level made in the claim uses terms which are defined in regulations of the Secretary,

(ii) may not state the absence of a nutrient unless—

(I) the nutrient is usually present in the food or in a food which substitutes for the food as defined by the Secretary by regulation, or

(II) the Secretary by regulation permits such a statement on the basis of a finding that such a statement would assist consumers in maintaining healthy dietary practices and the statement discloses that the nutrient is not usually present in the food,

(iii) may not be made with respect to the level of cholesterol in the food if the food contains, as determined by the Secretary by regulation, fat or saturated fat in an amount which increases to persons in the general population the risk of disease or a health related condition which is diet related unless—

(I) the Secretary finds by regulation that the level of cholesterol is substantially less than the level usually present in the food or in a food which substitutes for the food and which has a significant market share, or the Secretary by regulation permits a statement regarding the absence of cholesterol on the basis of a finding that cholesterol is not usually present in the food and that such a statement would assist consumers in maintaining healthy dietary practices and the regulation requires that the statement disclose that cholesterol is not usually present in the food, and

(II) the label or labeling of the food discloses the level of such fat or saturated fat in immediate proximity to such claim and with appropriate prominence which shall be no less than one-half the size of the claim with respect to the level of cholesterol,

(iv) may not be made with respect to the level of saturated fat in the food if the food contains cholesterol unless the label or labeling of the food discloses the level of cholesterol in the food in immediate proximity to such claim and with appropriate prominence which shall be no less than one-half the size of the claim with respect to the level of saturated fat,

(v) may not state that a food is high in dietary fiber unless the food is low in total fat as defined by the Secretary or the label or labeling discloses the level of total fat in the food in immediate proximity to such statement and with appropriate prominence which shall be no less than one-half the size of the claim with respect to the level of dietary fiber, and

(vi) may not be made if the Secretary by regulation prohibits the claim because the claim is misleading in light of the level of another nutrient in the food.

(B) If a claim described in subparagraph (1)(A) is made with respect to a nutrient in a food and the Secretary makes a determination that the food contains a nutrient at a level that increases to persons in the general population the risk of a disease or health-related condition that is diet related, the label or labeling of such food shall contain, prominently and in immediate proximity to such claim, the following statement: “See nutrition information for ——— content.” The blank shall identify the nutrient associated with the increased disease or health-related condition risk. In making the determination described in this clause, the Secretary shall take into account the significance of the food in the total daily diet.

(C) Subparagraph (2)(A) does not apply to a claim described in subparagraph (1)(A) and contained in the label or labeling of a food if such claim is contained in the brand name of such food and such brand name was in use on such food before October 25, 1989, unless the brand name contains a term defined by the Secretary under subparagraph (2)(A)(i). Such a claim is subject to paragraph (a).

(D) Subparagraph (2) does not apply to a claim described in subparagraph (1)(A) which uses the term “diet” and is contained in the label or labeling of a soft drink if (i) such claim is contained in the brand name of such soft drink, (ii) such brand name was in use on such soft drink before October 25, 1989, and (iii) the use of the term “diet” was in conformity with section 105.66 of title 21 of the Code of Federal Regulations. Such a claim is subject to paragraph (a).

(E) Subclauses (i) through (v) of subparagraph (2)(A) do not apply to a statement in the label or labeling of food which describes the percentage of vitamins and minerals in the food in relation to the amount of such vitamins and minerals recommended for daily consumption by the Secretary.

(F) Subclause (i) clause (A) does not apply to a statement in the labeling of a dietary supplement that characterizes the percentage level of a dietary ingredient for which the Secretary has not established a reference daily intake, daily recommended value, or other recommendation for daily consumption.

(G) A claim of the type described in subparagraph (1)(A) for a nutrient, for which the Secretary has not promulgated a regulation under clause (A)(i), shall be authorized and may be made with respect to a

food if—

(i) a scientific body of the United States Government with official responsibility for public health protection or research directly relating to human nutrition (such as the National Institutes of Health or the Centers for Disease Control and Prevention) or the National Academy of Sciences or any of its subdivisions has published an authoritative statement, which is currently in effect, which identifies the nutrient level to which the claim refers;

(ii) a person has submitted to the Secretary, at least 120 days (during which the Secretary may notify any person who is making a claim as authorized by clause (C) that such person has not submitted all the information required by such clause) before the first introduction into interstate commerce of the food with a label containing the claim, (I) a notice of the claim, which shall include the exact words used in the claim and shall include a concise description of the basis upon which such person relied for determining that the requirements of subclause (i) have been satisfied, (II) a copy of the statement referred to in subclause (i) upon which such person relied in making the claim, and (III) a balanced representation of the scientific literature relating to the nutrient level to which the claim refers;

(iii) the claim and the food for which the claim is made are in compliance with clauses (A) and (B), and are otherwise in compliance with paragraph (a) and section 201(n) [21 USCS § 321(n)]; and

(iv) the claim is stated in a manner so that the claim is an accurate representation of the authoritative statement referred to in subclause (i) and so that the claim enables the public to comprehend the information provided in the claim and to understand the relative significance of such information in the context of a total daily diet.

For purposes of this clause, a statement shall be regarded as an authoritative statement of a scientific body described in subclause (i) only if the statement is published by the scientific body and shall not include a statement of an employee of the scientific body made in the individual capacity of the employee.

(H) A claim submitted under the requirements of clause (G) may be made until—

(i) such time as the Secretary issues a regulation—

(I) prohibiting or modifying the claim and the regulation has become effective, or

(II) finding that the requirements of clause (G) have not been met, including finding that the petitioner had not submitted all the information required by such clause; or

(ii) a district court of the United States in an enforcement proceeding under chapter III [21 USCS §§ 331 et seq.] has determined that the requirements of clause (G) have not been met.

(3) (A) Except as provided in subparagraph (5), a claim described in subparagraph (1)(B) may only be made—

(i) if the claim meets the requirements of the regulations of the Secretary promulgated under clause (B), and

(ii) if the food for which the claim is made does not contain, as determined by the Secretary by regulation, any nutrient in an amount which increases to persons in the general population the risk of a disease or health-related condition which is diet related, taking into account the significance of the food in the total daily diet, except that the Secretary may by regulation permit such a claim based on a finding that such a claim would assist consumers in maintaining healthy dietary practices and based on a requirement that the label contain a disclosure of the type required by subparagraph (2)(B).

(B) (i) The Secretary shall promulgate regulations authorizing claims of the type described in subparagraph (1)(B) only if the Secretary determines, based on the totality of publicly available scientific evidence (including evidence from well-designed studies conducted in a manner which is consistent with generally recognized scientific procedures and principles), that there is significant scientific agreement, among experts qualified by scientific training and experience to evaluate such claims, that the claim is supported by such evidence.

(ii) A regulation described in subclause (i) shall describe—

(I) the relationship between a nutrient of the type required in the label or labeling of food by paragraph (q)(1) or (q)(2) and a disease or health-related condition, and

(II) the significance of each such nutrient in affecting such disease or health-related condition.

(iii) A regulation described in subclause (i) shall require such claim to be stated in a manner so that the claim is an accurate representation of the matters set out in subclause (ii) and so that the claim en-

ables the public to comprehend the information provided in the claim and to understand the relative significance of such information in the context of a total daily diet.

(C) Notwithstanding the provisions of clauses (A)(i) and (B), a claim of the type described in subparagraph (1)(B) which is not authorized by the Secretary in a regulation promulgated in accordance with clause (B) shall be authorized and may be made with respect to a food if—

(i) a scientific body of the United States Government with official responsibility for public health protection or research directly relating to human nutrition (such as the National Institutes of Health or the Centers for Disease Control and Prevention) or the National Academy of Sciences or any of its subdivisions has published an authoritative statement, which is currently in effect, about the relationship between a nutrient and a disease or health-related condition to which the claim refers;

(ii) a person has submitted to the Secretary, at least 120 days (during which the Secretary may notify any person who is making a claim as authorized by clause (C) that such person has not submitted all the information required by such clause) before the first introduction into interstate commerce of the food with a label containing the claim, (I) a notice of the claim, which shall include the exact words used in the claim and shall include a concise description of the basis upon which such person relied for determining that the requirements of subclause (i) have been satisfied, (II) a copy of the statement referred to in subclause (i) upon which such person relied in making the claim, and (III) a balanced representation of the scientific literature relating to the relationship between a nutrient and a disease or health-related condition to which the claim refers;

(iii) the claim and the food for which the claim is made are in compliance with clause (A)(ii) and are otherwise in compliance with paragraph (a) and section 201(n) [21 USCS § 321(n)]; and

(iv) the claim is stated in a manner so that the claim is an accurate representation of the authoritative statement referred to in subclause (i) and so that the claim enables the public to comprehend the information provided in the claim and to understand the relative significance of such information in the context of a total daily diet.

For purposes of this clause, a statement shall be regarded as an authoritative statement of a scientific body described in subclause (i) only if the statement is published by the scientific body and shall not include a statement of an employee of the scientific body made in the individual capacity of the employee.

(D) A claim submitted under the requirements of clause (C) may be made until—

(i) such time as the Secretary issues a regulation under the standard in clause (B)(i)—

(I) prohibiting or modifying the claim and the regulation has become effective, or

(II) finding that the requirements of clause (C) have not been met, including finding that the petitioner has not submitted all the information required by such clause; or

(ii) a district court of the United States in an enforcement proceeding under chapter III [21 USCS §§ 331 et seq.] has determined that the requirements of clause (C) have not been met.

(4) (A) (i) Any person may petition the Secretary to issue a regulation under subparagraph (2)(A)(i) or (3)(B) relating to a claim described in subparagraph (1)(A) or (1)(B). Not later than 100 days after the petition is received by the Secretary, the Secretary shall issue a final decision denying the petition or file the petition for further action by the Secretary. If the Secretary does not act within such 100 days, the petition shall be deemed to be denied unless an extension is mutually agreed upon by the Secretary and the petitioner. If the Secretary denies the petition or the petition is deemed to be denied, the petition shall not be made available to the public. If the Secretary files the petition, the Secretary shall deny the petition or issue a proposed regulation to take the action requested in the petition not later than 90 days after the date of such decision. If the Secretary does not act within such 90 days, the petition shall be deemed to be denied unless an extension is mutually agreed upon by the Secretary and the petitioner. If the Secretary issues a proposed regulation, the rulemaking shall be completed within 540 days of the date the petition is received by the Secretary. If the Secretary does not issue a regulation within such 540 days, the Secretary shall provide the Committee on Commerce of the House of Representatives and the Committee on Labor and Human Resources of the Sen-

ate the reasons action on the regulation did not occur within such 540 days.

(ii) Any person may petition the Secretary for permission to use in a claim described in subparagraph (1)(A) terms that are consistent with the terms defined by the Secretary under subparagraph (2)(A)(i). Within 90 days of the submission of such a petition, the Secretary shall issue a final decision denying the petition or granting such permission.

(iii) Any person may petition the Secretary for permission to use an implied claim described in subparagraph (1)(A) in a brand name. After publishing notice of an opportunity to comment on the petition in the Federal Register and making the petition available to the public, the Secretary shall grant the petition if the Secretary finds that such claim is not misleading and is consistent with terms defined by the Secretary under subparagraph (2)(A)(i). The Secretary shall grant or deny the petition within 100 days of the date it is submitted to the Secretary and the petition shall be considered granted if the Secretary does not act on it within such 100 days.

(B) A petition under clause (A)(i) respecting a claim described in subparagraph (1)(A) or (1)(B) shall include an explanation of the reasons why the claim meets the requirements of this paragraph and a summary of the scientific data which supports such reasons.

(C) If a petition for a regulation under subparagraph (3)(B) relies on a report from an authoritative scientific body of the United States, the Secretary shall consider such report and shall justify any decision rejecting the conclusions of such report.

(5) (A) This paragraph does not apply to infant formulas subject to section 412(h) [21 USCS § 350a(h)] and medical foods as defined in section 5(b) of the Orphan Drug Act [21 USCS § 360ee(b)].

(B) Subclauses (iii) through (v) of subparagraph (2)(A) and subparagraph (2)(B) do not apply to food which is served in restaurants or other establishments in which food is served for immediate human consumption or which is sold for sale or use in such establishments.

(C) A subparagraph (1)(A) claim made with respect to a food which claim is required by a standard of identity issued under section 401 [21 USCS § 341] shall not be subject to subparagraph (2)(A)(i) or (2)(B).

(D) A subparagraph (1)(B) claim made with respect to a dietary supplement of vitamins, minerals, herbs, or other similar nutritional substances shall not be subject to subparagraph (3) but shall be subject to a procedure and standard, respecting the validity of such claim, established by regulation of the Secretary

(6) For purposes of paragraph (r)(1)(B), a statement for a dietary supplement may be made if—

(A) the statement claims a benefit related to a classical nutrient deficiency disease and discloses the prevalence of such disease in the United States, describes the role of a nutrient or dietary ingredient intended to affect the structure or function in humans, characterizes the documented mechanism by which a nutrient or dietary ingredient acts to maintain such structure or function, or describes general well-being from consumption of a nutrient or dietary ingredient,

(B) the manufacturer of the dietary supplement has substantiation that such statement is truthful and not misleading, and

(C) the statement contains, prominently displayed and in bold-face type, the following: "This statement has not been evaluated by the Food and Drug Administration. This product is not intended to diagnose, treat, cure, or prevent any disease."

A statement under this subparagraph may not claim to diagnose, mitigate, treat, cure, or prevent a specific disease or class of diseases. If the manufacturer of a dietary supplement proposes to make a statement described in the first sentence of this subparagraph in the labeling of the dietary supplement, the manufacturer shall notify the Secretary no later than 30 days after the first marketing of the dietary supplement with such statement that such a statement is being made.

(7) The Secretary may make proposed regulations issued under this paragraph effective upon publication pending consideration of public comment and publication of a final regulation if the Secretary determines that such action is necessary—

(A) to enable the Secretary to review and act promptly on petitions the Secretary determines provide for information necessary to—

(i) enable consumers to develop and maintain healthy dietary practices;

(ii) enable consumers to be informed promptly and effectively of important new knowledge regarding nutritional and health benefits of food; or

(iii) ensure that scientifically sound nutritional and health information is provided to consumers as soon as possible; or

(B) to enable the Secretary to act promptly to ban or modify a claim under this paragraph.

Such proposed regulations shall be deemed final agency action for purposes of judicial review.

(s) Dietary supplements

If—

(1) it is a dietary supplement; and

(2) (A) the label or labeling of the supplement fails to list—

(i) the name of each ingredient of the supplement that is described in section 201(ff) [21 USCS § 321(ff)]; and

(ii) (I) the quantity of each such ingredient; or

(II) with respect to a proprietary blend of such ingredients, the total quantity of all ingredients in the blend;

(B) the label or labeling of the dietary supplement fails to identify the product by using the term "dietary supplement", which term may be modified with the name of such an ingredient;

(C) the supplement contains an ingredient described in section 201(ff)(1)(C) [21 USCS § 321(ff)(1)(C)], and the label or labeling of the supplement fails to identify any part of the plant from which the ingredient is derived;

(D) the supplement—

(i) is covered by the specifications of an official compendium;

(ii) is represented as conforming to the specifications of an official compendium; and

(iii) fails to so conform; or

(E) the supplement—

(i) is not covered by the specifications of an official compendium; and

(ii) (I) fails to have the identity and strength that the supplement is represented to have; or

(II) fails to meet the quality (including tablet or capsule disintegration), purity, or compositional specifications, based on validated assay or other appropriate methods, that the supplement is represented to meet. A dietary supplement shall not be deemed misbranded solely because its label or labeling contains directions or conditions of use or warnings.

(t) If it purports to be or is represented as catfish, unless it is fish classified within the family Ictaluridae.

(u) If it purports to be or is represented as ginseng, unless it is an herb or herbal ingredient derived from a plant classified within the genus *Panax*.

(v) If—

(1) it fails to bear a label required by the Secretary under section 801(n)(1) [21 USCS § 381(n)(1)] (relating to food refused admission into the United States);

(2) the Secretary finds that the food presents a threat of serious adverse health consequences or death to humans or animals; and

(3) upon or after notifying the owner or consignee involved that the label is required under section 801 [21 USCS § 381], the Secretary informs the owner or consignee that the food presents such a threat.

§ 351. Adulterated drugs and devices

A drug or device shall be deemed to be adulterated—

(a) Poisonous, insanitary, etc., ingredients; adequate controls in manufacture. (1) If it consists in whole or in part of any filthy, putrid, or decomposed substance; or (2)(A) if it has been prepared, packed, or held under insanitary conditions whereby it may have been contaminated with filth, or whereby it may have been rendered injurious to health; or (B) if it is a drug and the methods used in, or the facilities or controls used for, its manufacture, processing, packing, or holding do not conform to or are not operated or administered in conformity with current good manufacturing practice to assure that such drug meets the requirements of this Act as to safety and has the identity and strength, and meets the quality and purity characteristics, which it purports or is represented to possess; or (C) if it is a compounded positron emission tomography drug and the methods used in, or the facilities and controls used for, its compounding, processing, packing, or holding do not conform to or are not operated or administered in conformity with the positron emission tomography compounding standards and the official monographs of the United States Pharmacopoeia to assure that such drug meets the requirements of this Act as to safety and has the identity and strength, and meets the quality and purity characteristics, that it purports or is represented to possess; or (3) if its container is com-

posed, in whole or in part, of any poisonous or deleterious substance which may render the contents injurious to health; or (4) if (A) it bears or contains, for purposes of coloring only, a color additive which is unsafe within the meaning of section 721(a) [21 USCS § 379e(a)], or (B) it is a color additive the intended use of which in or on drugs or devices is for purposes of coloring only and is unsafe within the meaning of section 721(a) [21 USCS § 379e(a)]; or (5) if it is a new animal drug which is unsafe within the meaning of section 512 [21 USCS § 360b]; or (6) if it is an animal feed bearing or contaminating a new animal drug, and such animal feed is unsafe within the meaning of section 512 [21 USCS § 360f].

(b) Strength, quality, or purity differing from official compendium. If it purports to be or is represented as a drug the name of which is recognized in an official compendium, and its strength differs from, or its quality or purity falls below, the standard set forth in such compendium. Such determination as to strength, quality, or purity shall be made in accordance with the tests or methods of assay set forth in such compendium, except that whenever tests or methods of assay have not been prescribed in such compendium, or such tests or methods of assay as are prescribed are, in the judgment of the Secretary, insufficient for the making of such determination, the Secretary shall bring such fact to the attention of the appropriate body charged with the revision of such compendium, and if such body fails within a reasonable time to prescribe tests or methods of assay which, in the judgment of the Secretary, are sufficient for purposes of this paragraph, then the Secretary shall promulgate regulations prescribing appropriate tests or methods of assay in accordance with which such determination as to strength, quality, or purity shall be made. No drug defined in an official compendium shall be deemed to be adulterated under this paragraph because it differs from the standard of strength, quality, or purity therefore set forth in such compendium, if its difference in strength, quality, or purity from such standard is plainly stated on its label. Whenever a drug is recognized in both the United States Pharmacopoeia and the Homoeopathic Pharmacopoeia of the United States it shall be subject to the requirements of the United States Pharmacopoeia unless it is labeled and offered for sale as a homoeopathic drug, in which case it shall be subject to the provisions of the Homoeopathic Pharmacopoeia of the United States and not to those of the United States Pharmacopoeia.

(c) Misrepresentation of strength, etc., where drug is unrecognized in compendium. If it is not subject to the provisions of paragraph (b) of this section and its strength differs from, or its purity or quality falls below, that which it purports to be or is represented to possess.

(d) Mixture with or substitution of another substance. If it is a drug and any substance has been (1) mixed or packed therewith so as to reduce its quality or strength or (2) substituted wholly or in part therefor.

(e) Devices not in conformity with performance standards.

(1) If it is, or purports to be or is represented as, a device which is subject to a performance standard established under section 514 [21 USCS § 360d], unless such device is in all respects in conformity with such standard.

(2) If it is declared to be, purports to be, or is represented as, a device that is in conformity with any standard recognized under section 514(c) [21 USCS § 360d(c)] unless such device is in all respects in conformity with such standard.

(f) Certain class III devices.

(1) If it is a class III device—

(A) (i) which is required by a regulation promulgated under subsection (b) of section 515 [21 USCS § 360e] to have an approval under such section of an application for premarket approval and which is not exempt from section 515 [21 USCS § 360e] under section 520(g) [21 USCS § 360(g)], and

(ii) (I) for which an application for premarket approval or a notice of completion of a product development protocol was not filed with the Secretary within the ninety-day period beginning on the date of the promulgation of such regulation, or

(II) for which such an application was filed and approval of the application has been denied, suspended, or withdrawn, or such a notice was filed and has been declared not completed or the approval of the device under the protocol has been withdrawn;

(B) (i) which was classified under section 513(f) [21 USCS § 360c(f)] into class III, which under section 515(a) [21 USCS § 360e(a)] is required to have in effect an approved application for premarket approval, and which is not exempt from section 515 [21 USCS § 360e]

under section 520(g) [21 USCS § 360(g)], and

(ii) which has an application which has been suspended or is otherwise not in effect; or

(C) which was classified under section 520(l) [21 USCS § 360j(l)] into class III, which under such section is required to have in effect an approved application under section 515 [21 USCS § 360e], and which has an application which has been suspended or is otherwise not in effect.

(2) (A) In the case of a device classified under section 513(f) [21 USCS § 360c(f)] into class III and intended solely for investigational use, paragraph (1)(B) shall not apply with respect to such device during the period ending on the ninetieth day after the date of the promulgation of the regulations prescribing the procedures and conditions required by section 520(g)(2) [21 USCS § 360(g)(2)].

(B) In the case of a device subject to a regulation promulgated under subsection (b) of section 515 [21 USCS § 360e(b)], paragraph (1) shall not apply with respect to such device during the period ending—

(i) on the last day of the thirtieth calendar month beginning after the month in which the classification of the device in class III became effective under section 513 [21 USCS § 360c], or

(ii) on the ninetieth day after the date of the promulgation of such regulation, whichever occurs later.

(g) Banned devices. If it is a banned device.

(h) Manufacture, packing, storage, or installation of device not in conformity with applicable requirements or conditions. If it is a device and the methods used in, or the facilities or controls used for, its manufacture, packing, storage, or installation are not in conformity with applicable requirements under section 520(f)(1) [21 USCS § 360(f)(1)] or an applicable condition prescribed by an order under section 520(f)(2) [21 USCS § 360(f)(2)].

(i) Failure to comply with requirements under which device was exempted for investigational use. If it is a device for which an exemption has been granted under section 520(g) [21 USCS § 360(g)] for investigational use and the person who was granted such exemption or any investigator who uses such device under such exemption fails to comply with a requirement prescribed by or under such section.

#### § 352. Misbranded drugs and devices

A drug or device shall be deemed to be misbranded—

(a) False or misleading label. If its labeling is false or misleading in any particular. Health care economic information provided to a formulary committee, or other similar entity, in the course of the committee or the entity carrying out its responsibilities for the selection of drugs for managed care or other similar organizations, shall not be considered to be false or misleading under this paragraph if the health care economic information directly relates to an indication approved under section 505 [21 USCS § 355] or under section 351(a) of the Public Health Service Act [42 USCS § 262(a)] for such drug and is based on competent and reliable scientific evidence. The requirements set forth in section 505(a) [21 USCS § 355(a)] or in section 351(a) of the Public Health Service Act [42 USCS § 262(a)] shall not apply to health care economic information provided to such a committee or entity in accordance with this paragraph. Information that is relevant to the substantiation of the health care economic information presented pursuant to this paragraph shall be made available to the Secretary upon request. In this paragraph, the term “health care economic information” means any analysis that identifies, measures, or compares the economic consequences, including the costs of the represented health outcomes, of the use of a drug to the use of another drug, to another health care intervention, or to no intervention.

(b) Package form; Contents of label. If in package form unless it bears a label containing (1) the name and place of business of the manufacturer, packer, or distributor; and (2) an accurate statement of the quantity of the contents in terms of weight, measure, or numerical count: Provided, That under clause (2) of this paragraph reasonable variations shall be permitted, and exemptions as to small packages shall be established, by regulations prescribed by the Secretary.

(c) Prominence of information on label. If any word, statement, or other information required by or under authority of this Act to appear on the label or labeling is not prominently placed thereon with such conspicuousness (as compared with other words, statements, designs, or devices, in the labeling) and in such terms as to render it likely to be read and understood by the ordinary individual under customary conditions of purchase and use.

(d) [Repealed]

(e) Designation of drugs or devices by established names.

(1) (A) If it is a drug, unless its label bears, to the exclusion of any other nonproprietary name (except the applicable systematic chemical name or the chemical formula)—

(i) the established name (as defined in subparagraph (3)) of the drug, if there is such a name;

(ii) the established name and quantity or, if determined to be appropriate by the Secretary, the proportion of each active ingredient, including the quantity, kind, and proportion of any alcohol, and also including whether active or not the established name and quantity or if determined to be appropriate by the Secretary, the proportion of any bromides, ether, chloroform, acetanilide, acetophenetidin, amidopyrine, antipyrine, atropine, hyoscyne, hyoscyamine, arsenic, digitalis, digitalis glucosides, mercury, ouabain, strophanthin, strychnine, thyroid, or any derivative or preparation of any such substances, contained therein, except that the requirement for stating the quantity of the active ingredients, other than the quantity of those specifically named in this subclause, shall not apply to nonprescription drugs not intended for human use; and

(iii) the established name of each inactive ingredient listed in alphabetical order on the outside container of the retail package and, if determined to be appropriate by the Secretary, on the immediate container, as prescribed in regulation promulgated by the Secretary, except that nothing in this subclause shall be deemed to require that any trade secret be divulged, and except that the requirements of this subclause with respect to alphabetical order shall apply only to nonprescription drugs that are not also cosmetics and that this subclause shall not apply to nonprescription drugs not intended for human use.

(B) For any prescription drug the established name of such drug or ingredient, as the case may be, on such label (and on any labeling on which a name for such drug or ingredient is used) shall be printed prominently and in type at least half as large as that used thereon for any proprietary name or designation for such drug or ingredient, except that to the extent that compliance with the requirements of subclause (ii) or (iii) of clause (A) or this clause is impracticable, exemptions shall be established by regulations promulgated by the Secretary.

(2) If it is a device and it has an established name, unless its label bears, to the exclusion of any other nonproprietary name, its established name (as defined in subparagraph (4)) prominently printed in type at least half as large as that used thereon for any proprietary name or designation for such device, except that to the extent compliance with the requirements of this subparagraph is impracticable, exemptions shall be established by regulations promulgated by the Secretary.

(3) As used in subparagraph (1), the term “established name,” with respect to a drug or ingredient thereof, means (A) the applicable official name designated pursuant to section 508 [21 USCS § 358], or (B), if there is no such name and such drug, or such ingredient, is an article recognized in an official compendium, then the official title thereof in such compendium, or (C) if neither clause (A) nor clause (B) of this subparagraph applies, then the common or usual name, if any, of such drug or of such ingredient, except that where clause (B) of this subparagraph applies to an article recognized in the United States Pharmacopeia and in the Homoeopathic Pharmacopeia under different official titles, the official title used in the United States Pharmacopeia shall apply unless it is labeled and offered for sale as a homoeopathic drug, in which case the official title used in the Homoeopathic Pharmacopeia shall apply.

(4) As used in subparagraph (2), the term “established name” with respect to a device means (A) the applicable official name of the device designated pursuant to section 508 [21 USCS § 358], (B) if there is no such name and such device is an article recognized in an official compendium, then the official title thereof in such compendium, or (C) if neither clause (A) nor clause (B) of this subparagraph applies, then any common or usual name of such device.

(f) Directions for use and warnings on label. Unless its labeling bears (1) adequate directions for use; and (2) such adequate warnings against use in those pathological conditions or by children where its use may be dangerous to health, or against unsafe dosage or methods or duration of administration or application, in such manner and form, as are necessary for the protection of users, except that where any requirement of clause (1) of this paragraph, as applied to any drug or device, is not necessary for the protection of the public health, the Secretary shall promulgate regulations exempting such drug or device from such

requirement. Required labeling for prescription devices intended for use in health care facilities may be made available solely by electronic means provided that the labeling complies with all applicable requirements of law and, that the manufacturer affords health care facilities the opportunity to request the labeling in paper form, and after such request, promptly provides the health care facility the requested information without additional cost.

(g) Representations as recognized drug; packing and labeling; inconsistent requirements for designation of drug. If it purports to be a drug the name of which is recognized in an official compendium, unless it is packaged and labeled as prescribed therein. The method of packing may be modified with the consent of the Secretary. Whenever a drug is recognized in both the United States Pharmacopeia and the Homoeopathic Pharmacopeia of the United States it shall be subject to the requirements of the United States Pharmacopeia with respect to packaging and labeling unless it is labeled and offered for sale as a homoeopathic drug, in which case it shall be subject to the provisions of the Homoeopathic Pharmacopeia of the United States, and not to those of the United States Pharmacopeia, except that in the event of inconsistency between the requirements of this paragraph and those of paragraph (e) as to the name by which the drug or its ingredients shall be designated, the requirements of paragraph (e) shall prevail.

(h) Deteriorative drugs; packing and labeling. If it has been found by the Secretary to be a drug liable to deterioration, unless it is packaged in such form and manner, and its label bears a statement of such precautions, as the Secretary shall by regulations require as necessary for the protection of the public health. No such regulation shall be established for any drug recognized in an official compendium until the Secretary shall have informed the appropriate body charged with the revision of such compendium of the need for such packaging or labeling requirements and such body shall have failed within a reasonable time to prescribe such requirements.

(i) Drug; misleading container; imitation; offer for sale under another name. If it is a drug and its container is so made, formed, or filled as to be misleading, or (2) if it is an imitation of another drug; or (3) if it is offered for sale under the name of another drug.

(j) Health-endangering when used as prescribed. If it is dangerous to health when used in the dosage, or manner or with the frequency or duration prescribed, recommended, or suggested in the labeling thereof.

(k), (l) [Repealed]

(m) Color additives; packing and labeling. If it is a color additive the intended use of which is for the purpose of coloring only, unless its packaging and labeling are in conformity with such packaging and labeling requirements applicable to such color additive, as may be contained in regulations issued under section 721 [21 USCS § 379c].

(n) Prescription drug advertisements: established name; quantitative formula; side effects, contraindications, and effectiveness; prior approval; false advertising; labeling; construction of the Convention on Psychotropic Substances. In the case of any prescription drug distributed or offered for sale in any State, unless the manufacturer, packer, or distributor thereof includes in all advertisements and other descriptive printed matter issued or caused to be issued by the manufacturer, packer, or distributor with respect to that drug a true statement of (1) the established name as defined in section 502(e) [subsec. (e) of this section], printed prominently and in type at least half as large as that used for any trade or brand name thereof, (2) the formula showing quantitatively each ingredient of such drug to the extent required for labels under section 502(e) [subsec. (e) of this section], and (3) such other information in brief summary relating to side effects, contraindications, and effectiveness as shall be required in regulations which shall be issued by the Secretary in accordance with the procedure specified in section 701(e) of this Act [21 USCS § 371(e)], except that (A) except in extraordinary circumstances, no regulation issued under this paragraph shall require prior approval by the Secretary of the content of any advertisement, and (B) no advertisement of a prescription drug, published after the effective date of regulations issued under this paragraph applicable to advertisements of prescription drugs, shall, with respect to the matters specified in this paragraph or covered by such regulations, be subject to the provisions of sections 12 through 17 of the Federal Trade Commission Act, as amended [15 USCS §§ 52-57]. This paragraph (n) shall not be applicable to any printed matter which the Secretary determines to be labeling as defined in section 201(m) of this Act [21 USCS § 321(m)]. Nothing in the Convention on Psychotropic Substances, signed at Vienna, Austria, on February 21, 1971, shall be construed to

prevent drug price communications to consumers.

(o) Drugs or devices from nonregistered establishments. If it was manufactured, prepared, propagated, compounded, or processed in an establishment in any State not duly registered under section 510 [21 USCS § 360], if it was not included in a list required by section 510(j) [21 USCS § 360(j)], if a notice or other information respecting it was not provided as required by such section or section 510(k) [21 USCS § 360(k)], or if it does not bear such symbols from the uniform system for identification of devices prescribed under section 510(e) [21 USCS § 360(e)] as the Secretary by regulation requires.

(p) Packaging or labeling of drugs in violation of regulations. If it is a drug and its packaging or labeling is in violation of an applicable regulation issued pursuant to section 3 or 4 of the Poison Prevention Packaging Act of 1970 [15 USCS § 1472 or 1473].

(q) Restricted devices using false or misleading advertising or used in violation of regulations. In the case of any restricted device distributed or offered for sale in any State, if (1) its advertising is false or misleading in any particular, or (2) it is sold, distributed, or used in violation of regulations prescribed under section 520(e) [21 USCS § 360(j)(e)].

(r) Restricted devices not carrying requisite accompanying statements in advertisements and other descriptive printed matter. In the case of any restricted device distributed or offered for sale in any State, unless the manufacturer, packer, or distributor thereof includes in all advertisements and other descriptive printed matter issued or caused to be issued by the manufacturer, packer, or distributor with respect to that device (1) a true statement of the device's established name as defined in section 502(e) [21 USCS § 352(e)], printed prominently and in type at least half as large as that used for any trade or brand name thereof, and (2) a brief statement of the intended uses of the device and relevant warnings, precautions, side effects, and contra-indications and, in the case of specific devices made subject to a finding by the Secretary after notice and opportunity for comment that such action is necessary to protect the public health, a full description of the components of such device or the formula showing quantitatively each ingredient of such device to the extent required in regulations which shall be issued by the Secretary after an opportunity for a hearing. Except in extraordinary circumstances, no regulation issued under this paragraph shall require prior approval by the Secretary of the content of any advertisement and no advertisement of a restricted device, published after the effective date of this paragraph shall, with respect to the matters specified in this paragraph or covered by regulations issued hereunder, be subject to the provisions of sections 12 through 15 of the Federal Trade Commission Act (15 U.S.C. 52-55). This paragraph shall not be applicable to any printed matter which the Secretary determines to be labeling as defined in section 201(m) [21 USCS § 321(m)].

(s) Devices subject to performance standards not bearing requisite labeling. If it is a device subject to a performance standard established under section 514 [21 USCS § 360d], unless it bears such labeling as may be prescribed in such performance standard.

(t) Devices for which there has been a failure or refusal to give required notification or to furnish required material or information. If it is a device and there was a failure or refusal (1) to comply with any requirement prescribed under section 518 [21 USCS § 360h] respecting the device, (2) to furnish any material or information required by or under section 519 [21 USCS § 360i] respecting the device, or (3) to comply with a requirement under section 522 [21 USCS § 360l].

#### § 361. Adulterated cosmetics

A cosmetic shall be deemed to be adulterated—

(a) If it bears or contains any poisonous or deleterious substance which may render it injurious to users under the conditions of use prescribed in the labeling thereof, or under such conditions of use as are customary or usual, except that this provision shall not apply to coal-tar hair dye, the label of which bears the following legend conspicuously displayed thereon: "Caution—This product contains ingredients which may cause skin irritation on certain individuals and a preliminary test according to accompanying directions should first be made. This product must not be used for dyeing the eyelashes or eyebrows; to do so may cause blindness.", and the labeling of which bears adequate directions for such preliminary testing. For the purposes of this paragraph and paragraph (e) the term "hair dye" shall not include eyelash dyes or eyebrow dyes.

(b) If it consists in whole or in part of any filthy, putrid, or decomposed substance.

(c) If it has been prepared, packed, or held under insanitary conditions

whereby it may have become contaminated with filth, or whereby it may have been rendered injurious to health.

(d) If its container is composed in whole or in part, of any poisonous or deleterious substance which may render the contents injurious to health.

(e) If it is not a hair dye and it is, or it bears or contains, a color additive which is unsafe within the meaning of section 721(a) [21 USCS § 379e(a)].

#### § 362. Misbranded cosmetics

A cosmetic shall be deemed to be misbranded—

(a) If its labeling is false or misleading in any particular.

(b) If in package form unless it bears a label containing (1) the name and place of business of the manufacturer, packer, or distributor; and (2) an accurate statement of the quantity of the contents in terms of weight, measure, or numerical count: Provided, That under clause (2) of this paragraph reasonable variations shall be permitted, and exemptions as to small packages shall be established, by regulations prescribed by the Secretary.

(c) If any word, statement, or other information required by or under authority of this Act to appear on the label or labeling is not prominently placed thereon with such conspicuousness (as compared with other words, statements, designs, or devices, in the labeling) and in such terms as to render it likely to be read and understood by the ordinary individual under customary conditions of purchase and use.

(d) If its container is so made, formed, or filled as to be misleading.

(e) If it is a color additive, unless its packaging and labeling are in conformity with such packaging and labeling requirements, applicable to such color additive, as may be contained in regulations issued under section 721 [21 USCS § 379e]. This paragraph shall not apply to packages of color additives which, with respect to their use for cosmetics, are marketed and intended for use only in or on hair dyes (as defined in the last sentence of section 601(a) [21 USCS § 361(a)]).

(f) If its packaging or labeling is in violation of an applicable regulation issued pursuant to section 3 or 4 of the Poison Prevention Packaging Act of 1970 [15 USCS § 1472 or 1473].

#### § 371. Regulations and hearings

(a) Authority to promulgate regulations. The authority to promulgate regulations for the efficient enforcement of this Act, except as otherwise provided in this section, is hereby vested in the Secretary.

(b) Regulations for imports and exports. The Secretary of the Treasury and the Secretary of Health and Human Services shall jointly prescribe regulations for the efficient enforcement of the provisions of section 801 [21 USCS § 381], except as otherwise provided therein. Such regulations shall be promulgated in such manner and take effect at such time, after due notice, as the Secretary of Health and Human Services shall determine.

(c) Conduct of hearings. Hearings authorized or required by this Act shall be conducted by the Secretary or such officer or employee as he may designate for the purpose.

(d) Effectiveness of definitions and standards of identity. The definitions and standards of identity promulgated in accordance with the provisions of this Act shall be effective for the purposes of the enforcement of this Act, notwithstanding such definitions and standards as may be contained in other laws of the United States and regulations promulgated thereunder.

(e) Procedure for establishment.

(1) Any action for the issuance, amendment, or repeal of any regulation under section 403(j), 404(a), 406, 501(b), or 502 (d) or (h) of this Act [21 USCS § 343(j), 344(a), 346, 351(b) or 352(d) or (h)], and any action for the amendment or repeal of any definition and standard of identity under section 401 of this Act [21 USCS § 341] for any dairy product (including products regulated under parts 131, 133 and 135 of title 21, Code of Federal Regulations) shall be begun by a proposal made (A) by the Secretary on his own initiative, or (B) by petition of any interested person, showing reasonable grounds therefor, filed with the Secretary. The Secretary shall publish such proposal and shall afford all interested persons an opportunity to present their views thereon, orally or in writing. As soon as practicable thereafter, the Secretary shall by order act upon such proposal and shall make such order public. Except as provided in paragraph (2), the order shall become effective at such time as may be specified therein, but not prior to the day following the last day on which objections may be filed under such paragraph.

(2) On or before the thirtieth day after the date on which an order

entered under paragraph (1) is made public, any person who will be adversely affected by such order if placed in effect may file objections thereto with the Secretary, specifying with particularity the provisions of the order deemed objectionable, stating the grounds therefor, and requesting a public hearing upon such objections. Until final action upon such objections is taken by the Secretary under paragraph (3), the filing of such objections shall operate to stay the effectiveness of those provisions of the order to which the objections are made. As soon as practicable after the time for filing objections has expired the Secretary shall publish a notice in the Federal Register specifying those parts of the order which have been stayed by the filing of objections and, if no objections have been filed, stating that fact.

(3) As soon as practicable after such request for a public hearing, the Secretary, after due notice, shall hold such a public hearing for the purpose of receiving evidence relevant and material to the issues raised by such objections. At the hearing, any interested person may be heard in person or by representative. As soon as practicable after completion of the hearing, the Secretary shall by order act upon such objections and make such order public. Such order shall be based only on substantial evidence of record at such hearing and shall set forth, as part of the order, detailed findings of fact on which the order is based. The Secretary shall specify in the order the date on which it shall take effect, except that it shall not be made to take effect prior to the ninetieth day after its publication unless the Secretary finds that emergency conditions exist necessitating an earlier effective date, in which event the Secretary shall specify in the order his findings as to such conditions.

(f) Review of order.

(1) In a case of actual controversy as to the validity of any order under subsection (e), any person who will be adversely affected by such order if placed in effect may at any time prior to the ninetieth day after such order is issued file a petition with the Circuit Court of Appeals of the United States [United States Court of Appeals] for the circuit wherein such person resides or has his principal place of business, for a judicial review of such order. A copy of the petition shall be forthwith transmitted by the clerk of the court to the Secretary or other officer designated by him for that purpose. The Secretary thereupon shall file in the court the record of the proceedings on which the Secretary based his order, as provided in section 2112 of title 28, United States Code.

(2) If the petitioner applies to the court for leave to adduce additional evidence, and shows to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the proceedings before the Secretary, the court may order such additional evidence (and evidence in rebuttal thereof) to be taken before the Secretary, and to be adduced upon the hearing, in such manner and upon such terms and conditions as to the court may seem proper. The Secretary may modify his findings as to the facts, or make new findings, by reason of the additional evidence so taken, and he shall file such modified or new findings, and his recommendations, if any, for the modification or setting aside of his original order, with the return of such additional evidence.

(3) Upon the filing of the petition referred to in paragraph (1) of this subsection, the court shall have jurisdiction to affirm the order, or to set it aside in whole or in part, temporarily or permanently. If the order of the Secretary refuses to issue, amend, or repeal a regulation and such order is not in accordance with the law the court shall by its judgment order the Secretary to take action, with respect to such regulation, in accordance with law. The findings of the Secretary as to the facts, if supported by substantial evidence, shall be conclusive.

(4) The judgment of the court affirming or setting aside, in whole or in part, any such order of the Secretary shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28, United States Code, as amended.

(5) Any action instituted under this subsection shall survive notwithstanding any change in the person occupying the office of Secretary or any vacancy in such office.

(6) The remedies provided for in this subsection shall be in addition to and not in substitution for any other remedies provided by law.

(g) Copies of records of hearings. A certified copy of the transcript of the record and proceedings under subsection (e) shall be furnished by the Secretary to any interested party at his request, and payment of the costs thereof, and shall be admissible in any criminal, libel for condemnation, exclusion of imports, or other proceeding arising under or in

respect to this Act, irrespective of whether proceedings with respect to the order have previously been instituted or become final under subsection (f).

(h) Guidance documents.

(1) (A) The Secretary shall develop guidance documents with public participation and ensure that information identifying the existence of such documents and the documents themselves are made available to the public both in written form and, as feasible, through electronic means. Such documents shall not create or confer any rights for or on any person, although they present the views of the Secretary on matters under the jurisdiction of the Food and Drug Administration.

(B) Although guidance documents shall not be binding on the Secretary, the Secretary shall ensure that employees of the Food and Drug Administration do not deviate from such guidances without appropriate justification and supervisory concurrence. The Secretary shall provide training to employees in how to develop and use guidance documents and shall monitor the development and issuance of such documents.

(C) For guidance documents that set forth initial interpretations of a statute or regulation, changes in interpretation or policy that are of more than a minor nature, complex scientific issues, or highly controversial issues, the Secretary shall ensure public participation prior to implementation of guidance documents, unless the Secretary determines that such prior public participation is not feasible or appropriate. In such cases, the Secretary shall provide for public comment upon implementation and take such comment into account.

(D) For guidance documents that set forth existing practices or minor changes in policy, the Secretary shall provide for public comment upon implementation.

(2) In developing guidance documents, the Secretary shall ensure uniform nomenclature for such documents and uniform internal procedures for approval of such documents. The Secretary shall ensure that guidance documents and revisions of such documents are properly dated and indicate the nonbinding nature of the documents. The Secretary shall periodically review all guidance documents and, where appropriate, revise such documents.

(3) The Secretary, acting through the Commissioner, shall maintain electronically and update and publish periodically in the Federal Register a list of guidance documents. All such documents shall be made available to the public.

(4) The Secretary shall ensure that an effective appeals mechanism is in place to address complaints that the Food and Drug Administration is not developing and using guidance documents in accordance with this subsection.

(5) Not later than July 1, 2000, the Secretary after evaluating the effectiveness of the Good Guidance Practices document, published in the Federal Register at 62 Fed. Reg. 8961, shall promulgate a regulation consistent with this subsection specifying the policies and procedures of the Food and Drug Administration for the development, issuance, and use of guidance documents.

#### **False Claims Act**

#### **Title 31. Money and Finance**

#### **Subtitle III. Financial Management**

#### **Chapter 37. Claims**

#### **Subchapter III. Claims Against the United States Government**

#### **§ 3729. False claims**

(a) Liability for certain acts. Any person who—

(1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;

(2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government;

(3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid;

(4) has possession, custody, or control of property or money used, or to be used, by the Government and, intending to defraud the Government or willfully to conceal the property, delivers, or causes to be delivered, less property than the amount for which the person receives a certificate or receipt;

(5) authorized to make or deliver a document certifying receipt of



property used, or to be used, by the Government and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true;

(6) knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge the property; or

(7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government, is liable to the United States Government for a civil penalty of not less than \$ 5,000 and not more than \$ 10,000, plus 3 times the amount of damages which the Government sustains because of the act of that person, except that if the court finds that—

(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

(B) such person fully cooperated with any Government investigation of such violation; and

(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation; the court may assess not less than 2 times the amount of damages which the Government sustains because of the act of the person. A person violating this subsection shall also be liable to the United States Government for the costs of a civil action brought to recover any such penalty or damages.

(b) Knowing and knowingly defined. For purposes of this section, the terms “knowing” and “knowingly” mean that a person, with respect to information—

(1) has actual knowledge of the information;

(2) acts in deliberate ignorance of the truth or falsity of the information; or

(3) acts in reckless disregard of the truth or falsity of the information, and no proof of specific intent to defraud is required.

(c) Claim defined. For purposes of this section, “claim” includes any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.

(d) Exemption from disclosure. Any information furnished pursuant to subparagraphs (A) through (C) of subsection (a) shall be exempt from disclosure under section 552 of title 5.

(e) Exclusion. This section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986.

§ 3730. Civil actions for false claims

(a) Responsibilities of the Attorney General. The Attorney General diligently shall investigate a violation under section 3729. If the Attorney General finds that a person has violated or is violating section 3729, the Attorney General may bring a civil action under this section against the person.

(b) Actions by private persons.

(1) A person may bring a civil action for a violation of section 3729 for the person and for the United States Government. The action shall be brought in the name of the Government. The action may be dismissed only if the court and the Attorney General give written consent to the dismissal and their reasons for consenting.

(2) A copy of the complaint and written disclosure of substantially all material evidence and information the person possesses shall be served on the Government pursuant to Rule 4(d)(4) of the Federal Rules of Civil Procedure. The complaint shall be filed in camera, shall remain under seal for at least 60 days, and shall not be served on the defendant until the court so orders. The Government may elect to intervene and proceed with the action within 60 days after it receives both the complaint and the material evidence and information.

(3) The Government may, for good cause shown, move the court for extensions of the time during which the complaint remains under seal under paragraph (2). Any such motions may be supported by affidavits or other submissions in camera. The defendant shall not be required to

respond to any complaint filed under this section until 20 days after the complaint is unsealed and served upon the defendant pursuant to Rule 4 of the Federal Rules of Civil Procedure.

(4) Before the expiration of the 60-day period or any extensions obtained under paragraph (3), the Government shall—

(A) proceed with the action, in which case the action shall be conducted by the Government; or

(B) notify the court that it declines to take over the action, in which case the person bringing the action shall have the right to conduct the action.

(5) When a person brings an action under this subsection, no person other than the Government may intervene or bring a related action based on the facts underlying the pending action.

(c) Rights of the parties to qui tam actions.

(1) If the Government proceeds with the action, it shall have the primary responsibility for prosecuting the action, and shall not be bound by an act of the person bringing the action. Such person shall have the right to continue as a party to the action, subject to the limitations set forth in paragraph (2).

(2) (A) The Government may dismiss the action notwithstanding the objections of the person initiating the action if the person has been notified by the Government of the filing of the motion and the court has provided the person with an opportunity for a hearing on the motion.

(B) The Government may settle the action with the defendant notwithstanding the objections of the person initiating the action if the court determines, after a hearing, that the proposed settlement is fair, adequate, and reasonable under all the circumstances. Upon a showing of good cause, such hearing may be held in camera.

(C) Upon a showing by the Government that unrestricted participation during the course of the litigation by the person initiating the action would interfere with or unduly delay the Government's prosecution of the case, or would be repetitious, irrelevant, or for purposes of harassment, the court may, in its discretion, impose limitations on the person's participation, such as—

(i) limiting the number of witnesses the person may call;

(ii) limiting the length of the testimony of such witnesses;

(iii) limiting the person's cross-examination of witnesses; or

(iv) otherwise limiting the participation by the person in the litigation.

(D) Upon a showing by the defendant that unrestricted participation during the course of the litigation by the person initiating the action would be for purposes of harassment or would cause the defendant undue burden or unnecessary expense, the court may limit the participation by the person in the litigation.

(3) If the Government elects not to proceed with the action, the person who initiated the action shall have the right to conduct the action. If the Government so requests, it shall be served with copies of all pleadings filed in the action and shall be supplied with copies of all deposition transcripts (at the Government's expense). When a person proceeds with the action, the court, without limiting the status and rights of the person initiating the action, may nevertheless permit the Government to intervene at a later date upon a showing of good cause.

(4) Whether or not the Government proceeds with the action, upon a showing by the Government that certain actions of discovery by the person initiating the action would interfere with the Government's investigation or prosecution of a criminal or civil matter arising out of the same facts, the court may stay such discovery for a period of not more than 60 days. Such a showing shall be conducted in camera. The court may extend the 60-day period upon a further showing in camera that the Government has pursued the criminal or civil investigation or proceedings with reasonable diligence and any proposed discovery in the civil action will interfere with the ongoing criminal or civil investigation or proceedings.

(5) Notwithstanding subsection (b), the Government may elect to pursue its claim through any alternate remedy available to the Government, including any administrative proceeding to determine a civil money penalty. If any such alternate remedy is pursued in another proceeding, the person initiating the action shall have the same rights in such proceeding as such person would have had if the action had continued under this section. Any finding of fact or conclusion of law made in such other proceeding that has become final shall be conclusive on all parties to an action under this section. For purposes of the preceding sentence, a finding or conclusion is final if it has been finally

determined on appeal to the appropriate court of the United States, if all time for filing such an appeal with respect to the finding or conclusion has expired, or if the finding or conclusion is not subject to judicial review.

(d) Award to qui tam plaintiff.

(1) If the Government proceeds with an action brought by a person under subsection (b), such person shall, subject to the second sentence of this paragraph, receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action. Where the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) relating to allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government [General] Accounting Office report, hearing, audit, or investigation, or from the news media, the court may award such sums as it considers appropriate, but in no case more than 10 percent of the proceeds, taking into account the significance of the information and the role of the person bringing the action in advancing the case to litigation. Any payment to a person under the first or second sentence of this paragraph shall be made from the proceeds. Any such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

(2) If the Government does not proceed with an action under this section, the person bringing the action or settling the claim shall receive an amount which the court decides is reasonable for collecting the civil penalty and damages. The amount shall be not less than 25 percent and not more than 30 percent of the proceeds of the action or settlement and shall be paid out of such proceeds. Such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

(3) Whether or not the Government proceeds with the action, if the court finds that the action was brought by a person who planned and initiated the violation of section 3729 upon which the action was brought, then the court may, to the extent the court considers appropriate, reduce the share of the proceeds of the action which the person would otherwise receive under paragraph (1) or (2) of this subsection, taking into account the role of that person in advancing the case to litigation and any relevant circumstances pertaining to the violation. If the person bringing the action is convicted of criminal conduct arising from his or her role in the violation of section 3729, that person shall be dismissed from the civil action and shall not receive any share of the proceeds of the action. Such dismissal shall not prejudice the right of the United States to continue the action, represented by the Department of Justice.

(4) If the Government does not proceed with the action and the person bringing the action conducts the action, the court may award to the defendant its reasonable attorneys' fees and expenses if the defendant prevails in the action and the court finds that the claim of the person bringing the action was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment.

(e) Certain actions barred.

(1) No court shall have jurisdiction over an action brought by a former or present member of the armed forces under subsection (b) of this section against a member of the armed forces arising out of such person's service in the armed forces.

(2) (A) No court shall have jurisdiction over an action brought under subsection (b) against a Member of Congress, a member of the judiciary, or a senior executive branch official if the action is based on evidence or information known to the Government when the action was brought.

(B) For purposes of this paragraph, "senior executive branch official" means any officer or employee listed in paragraphs (1) through (8) of section 101(f) of the Ethics in Government Act of 1978 (5 U.S.C. App.).

(3) In no event may a person bring an action under subsection (b) which is based upon allegations or transactions which are the subject of a civil suit or an administrative civil money penalty proceeding in which the Government is already a party.

(4) (A) No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions

in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government [General] Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

(B) For purposes of this paragraph, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information.

(f) Government not liable for certain expenses. The Government is not liable for expenses which a person incurs in bringing an action under this section.

(g) Fees and expenses to prevailing defendant. In civil actions brought under this section by the United States, the provisions of section 2412(d) of title 28 shall apply.

(h) Any employee who is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment by his or her employer because of lawful acts done by the employee on behalf of the employee or others in furtherance of an action under this section, including investigation for, initiation of, testimony for, or assistance in an action filed or to be filed under this section, shall be entitled to all relief necessary to make the employee whole. Such relief shall include reinstatement with the same seniority status such employee would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees. An employee may bring an action in the appropriate district court of the United States for the relief provided in this subsection.

§ 3731. False claims procedure

(a) A subpoena [subpoena] requiring the attendance of a witness at a trial or hearing conducted under section 3730 of this title may be served at any place in the United States.

(b) A civil action under section 3730 may not be brought—

(1) more than 6 years after the date on which the violation of section 3729 is committed, or

(2) more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances, but in no event more than 10 years after the date on which the violation is committed, whichever occurs last.

(c) In any action brought under section 3730, the United States shall be required to prove all essential elements of the cause of action, including damages, by a preponderance of the evidence.

(d) Notwithstanding any other provision of law, the Federal Rules of Criminal Procedure, or the Federal Rules of Evidence, a final judgment rendered in favor of the United States in any criminal proceeding charging fraud or false statements, whether upon a verdict after trial or upon a plea of guilty or nolo contendere, shall estop the defendant from denying the essential elements of the offense in any action which involves the same transaction as in the criminal proceeding and which is brought under subsection (a) or (b) of section 3730.

§ 3732. False claims jurisdiction

(a) Actions under section 3730. Any action under section 3730 may be brought in any judicial district in which the defendant or, in the case of multiple defendants, any one defendant can be found, resides, transacts business, or in which any act proscribed by section 3729 occurred. A summons as required by the Federal Rules of Civil Procedure shall be issued by the appropriate district court and served at any place within or outside the United States.

(b) Claims under state law. The district courts shall have jurisdiction over any action brought under the laws of any State for the recovery of funds paid by a State or local government if the action arises from the same transaction or occurrence as an action brought under section 3730.

§ 3733. Civil investigative demands

(a) In general.

(1) Issuance and service. Whenever the Attorney General has reason to believe that any person may be in possession, custody, or control of any documentary material or information relevant to a false claims law investigation, the Attorney General may, before commencing a civil proceeding under section 3730 or other false claims law, issue in writing and cause to be served upon such person, a civil investigative demand

requiring such person—

(A) to produce such documentary material for inspection and copying,

(B) to answer in writing written interrogatories with respect to such documentary material or information,

(C) to give oral testimony concerning such documentary material or information, or

(D) to furnish any combination of such material, answers, or testimony. The Attorney General may not delegate the authority to issue civil investigative demands under this subsection. Whenever a civil investigative demand is an express demand for any product of discovery, the Attorney General, the Deputy Attorney General, or an Assistant Attorney General shall cause to be served, in any manner authorized by this section, a copy of such demand upon the person from whom the discovery was obtained and shall notify the person to whom such demand is issued of the date on which such copy was served.

(2) Contents and deadlines.

(A) Each civil investigative demand issued under paragraph (1) shall state the nature of the conduct constituting the alleged violation of a false claims law which is under investigation, and the applicable provision of law alleged to be violated.

(B) If such demand is for the production of documentary material, the demand shall—

(i) describe each class of documentary material to be produced with such definiteness and certainty as to permit such material to be fairly identified;

(ii) prescribe a return date for each such class which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying; and

(iii) identify the false claims law investigator to whom such material shall be made available.

(C) If such demand is for answers to written interrogatories, the demand shall—

(i) set forth with specificity the written interrogatories to be answered;

(ii) prescribe dates at which time answers to written interrogatories shall be submitted; and

(iii) identify the false claims law investigator to whom such answers shall be submitted.

(D) If such demand is for the giving of oral testimony, the demand shall—

(i) prescribe a date, time, and place at which oral testimony shall be commenced;

(ii) identify a false claims law investigator who shall conduct the examination and the custodian to whom the transcript of such examination shall be submitted;

(iii) specify that such attendance and testimony are necessary to the conduct of the investigation;

(iv) notify the person receiving the demand of the right to be accompanied by an attorney and any other representative; and

(v) describe the general purpose for which the demand is being issued and the general nature of the testimony, including the primary areas of inquiry, which will be taken pursuant to the demand.

(E) Any civil investigative demand issued under this section which is an express demand for any product of discovery shall not be returned or returnable until 20 days after a copy of such demand has been served upon the person from whom the discovery was obtained.

(F) The date prescribed for the commencement of oral testimony pursuant to a civil investigative demand issued under this section shall be a date which is not less than seven days after the date on which demand is received, unless the Attorney General or an Assistant Attorney General designated by the Attorney General determines that exceptional circumstances are present which warrant the commencement of such testimony within a lesser period of time.

(G) The Attorney General shall not authorize the issuance under this section of more than one civil investigative demand for oral testimony by the same person unless the person requests otherwise or unless the Attorney General, after investigation, notifies that person in writing that an additional demand for oral testimony is necessary. The Attorney General may not, notwithstanding section 510 of title 28, authorize the performance, by any other officer, employee, or agency, of any function vested in the Attorney General under this subparagraph. (b) Protected material or information.

(1) In general. A civil investigative demand issued under subsection (a) may not require the production of any documentary material, the submission of any answers to written interrogatories, or the giving of any oral testimony if such material, answers, or testimony would be protected from disclosure under—

(A) the standards applicable to subpoenas or subpoenas duces tecum issued by a court of the United States to aid in a grand jury investigation; or

(B) the standards applicable to discovery requests under the Federal Rules of Civil Procedure, to the extent that the application of such standards to any such demand is appropriate and consistent with the provisions and purposes of this section.

(2) Effect on other orders, rules, and laws. Any such demand which is an express demand for any product of discovery supersedes any inconsistent order, rule, or provision of law (other than this section) preventing or restraining disclosure of such product of discovery to any person. Disclosure of any product of discovery pursuant to any such express demand does not constitute a waiver of any right or privilege which the person making such disclosure may be entitled to invoke to resist discovery of trial preparation materials.

(c) Service; jurisdiction.

(1) By whom served. Any civil investigative demand issued under subsection (a) may be served by a false claims law investigator, or by a United States marshal or a deputy marshal, at any place within the territorial jurisdiction of any court of the United States.

(2) Service in foreign countries. Any such demand or any petition filed under subsection (j) may be served upon any person who is not found within the territorial jurisdiction of any court of the United States in such manner as the Federal Rules of Civil Procedure prescribe for service in a foreign country. To the extent that the courts of the United States can assert jurisdiction over any such person consistent with due process, the United States District Court for the District of Columbia shall have the same jurisdiction to take any action respecting compliance with this section by any such person that such court would have if such person were personally within the jurisdiction of such court.

(d) Service upon legal entities and natural persons.

(1) Legal entities. Service of any civil investigative demand issued under subsection (a) or of any petition filed under subsection (j) may be made upon a partnership, corporation, association, or other legal entity by—

(A) delivering an executed copy of such demand or petition to any partner, executive officer, managing agent, or general agent of the partnership, corporation, association, or entity, or to any agent authorized by appointment or by law to receive service of process on behalf of such partnership, corporation, association, or entity;

(B) delivering an executed copy of such demand or petition to the principal office or place of business of the partnership, corporation, association, or entity; or

(C) depositing an executed copy of such demand or petition in the United States mails by registered or certified mail, with a return receipt requested, addressed to such partnership, corporation, association, or entity at its principal office or place of business.

(2) Natural persons. Service of any such demand or petition may be made upon any natural person by—

(A) delivering an executed copy of such demand or petition to the person; or

(B) depositing an executed copy of such demand or petition in the United States mails by registered or certified mail, with a return receipt requested, addressed to the person at the person's residence or principal office or place of business.

(e) Proof of service. A verified return by the individual serving any civil investigative demand issued under subsection (a) or any petition filed under subsection (j) setting forth the manner of such service shall be proof of such service. In the case of service by registered or certified mail, such return shall be accompanied by the return post office receipt of delivery of such demand.

(f) Documentary material.

(1) Sworn certificates. The production of documentary material in response to a civil investigative demand served under this section shall be made under a sworn certificate, in such form as the demand designates, by—

(A) in the case of a natural person, the person to whom the demand is directed, or

(B) in the case of a person other than a natural person, a person having knowledge of the facts and circumstances relating to such production and authorized to act on behalf of such person.

The certificate shall state that all of the documentary material required by the demand and in the possession, custody, or control of the person to whom the demand is directed has been produced and made available to the false claims law investigator identified in the demand.

(2) Production of materials. Any person upon whom any civil investigative demand for the production of documentary material has been served under this section shall make such material available for inspection and copying to the false claims law investigator identified in such demand at the principal place of business of such person, or at such other place as the false claims law investigator and the person thereafter may agree and prescribe in writing, or as the court may direct under subsection (j)(1). Such material shall be made so available on the return date specified in such demand, or on such later date as the false claims law investigator may prescribe in writing. Such person may, upon written agreement between the person and the false claims law investigator, substitute copies for originals of all or any part of such material.

(g) Interrogatories. Each interrogatory in a civil investigative demand served under this section shall be answered separately and fully in writing under oath and shall be submitted under a sworn certificate, in such form as the demand designates, by—

(1) in the case of a natural person, the person to whom the demand is directed, or

(2) in the case of a person other than a natural person, the person or persons responsible for answering each interrogatory.

If any interrogatory is objected to, the reasons for the objection shall be stated in the certificate instead of an answer. The certificate shall state that all information required by the demand and in the possession, custody, control, or knowledge of the person to whom the demand is directed has been submitted. To the extent that any information is not furnished, the information shall be identified and reasons set forth with particularity regarding the reasons why the information was not furnished.

(h) Oral examinations.

(1) Procedures. The examination of any person pursuant to a civil investigative demand for oral testimony served under this section shall be taken before an officer authorized to administer oaths and affirmations by the laws of the United States or of the place where the examination is held. The officer before whom the testimony is to be taken shall put the witness on oath or affirmation and shall, personally or by someone acting under the direction of the officer and in the officer's presence, record the testimony of the witness. The testimony shall be taken stenographically and shall be transcribed. When the testimony is fully transcribed, the officer before whom the testimony is taken shall promptly transmit a copy of the transcript of the testimony to the custodian. This subsection shall not preclude the taking of testimony by any means authorized by, and in a manner consistent with, the Federal Rules of Civil Procedure.

(2) Persons present. The false claims law investigator conducting the examination shall exclude from the place where the examination is held all persons except the person giving the testimony, the attorney for and any other representative of the person giving the testimony, the attorney for the Government, any person who may be agreed upon by the attorney for the Government and the person giving the testimony, the officer before whom the testimony is to be taken, and any stenographer taking such testimony.

(3) Where testimony taken. The oral testimony of any person taken pursuant to a civil investigative demand served under this section shall be taken in the judicial district of the United States within which such person resides, is found, or transacts business, or in such other place as may be agreed upon by the false claims law investigator conducting the examination and such person.

(4) Transcript of testimony. When the testimony is fully transcribed, the false claims law investigator or the officer before whom the testimony is taken shall afford the witness, who may be accompanied by counsel, a reasonable opportunity to examine and read the transcript, unless such examination and reading are waived by the witness. Any changes in form or substance which the witness desires to make shall be entered and identified upon the transcript by the officer or the false claims law investigator, with a statement of the reasons given by the witness for making such changes. The transcript shall then be signed

by the witness, unless the witness in writing waives the signing, is ill, cannot be found, or refuses to sign. If the transcript is not signed by the witness within 30 days after being afforded a reasonable opportunity to examine it, the officer or the false claims law investigator shall sign it and state on the record the fact of the waiver, illness, absence of the witness, or the refusal to sign, together with the reasons, if any, given therefor.

(5) Certification and delivery to custodian. The officer before whom the testimony is taken shall certify on the transcript that the witness was sworn by the officer and that the transcript is a true record of the testimony given by the witness, and the officer or false claims law investigator shall promptly deliver the transcript, or send the transcript by registered or certified mail, to the custodian.

(6) Furnishing or inspection of transcript by witness. Upon payment of reasonable charges therefor, the false claims law investigator shall furnish a copy of the transcript to the witness only, except that the Attorney General, the Deputy Attorney General, or an Assistant Attorney General may, for good cause, limit such witness to inspection of the official transcript of the witness' testimony.

(7) Conduct of oral testimony.

(A) Any person compelled to appear for oral testimony under a civil investigative demand issued under subsection (a) may be accompanied, represented, and advised by counsel. Counsel may advise such person, in confidence, with respect to any question asked of such person. Such person or counsel may object on the record to any question, in whole or in part, and shall briefly state for the record the reason for the objection. An objection may be made, received, and entered upon the record when it is claimed that such person is entitled to refuse to answer the question on the grounds of any constitutional or other legal right or privilege, including the privilege against self-incrimination. Such person may not otherwise object to or refuse to answer any question, and may not directly or through counsel otherwise interrupt the oral examination. If such person refuses to answer any question, a petition may be filed in the district court of the United States under subsection (j)(1) for an order compelling such person to answer such question.

(B) If such person refuses to answer any question on the grounds of the privilege against self-incrimination, the testimony of such person may be compelled in accordance with the provisions of part V of title 18 [18 USCS §§ 6001 et seq.].

(8) Witness fees and allowances. Any person appearing for oral testimony under a civil investigative demand issued under subsection (a) shall be entitled to the same fees and allowances which are paid to witnesses in the district courts of the United States.

(i) Custodians of documents, answers, and transcripts.

(1) Designation. The Attorney General shall designate a false claims law investigator to serve as custodian of documentary material, answers to interrogatories, and transcripts of oral testimony received under this section, and shall designate such additional false claims law investigators as the Attorney General determines from time to time to be necessary to serve as deputies to the custodian.

(2) Responsibility for materials; disclosure.

(A) A false claims law investigator who receives any documentary material, answers to interrogatories, or transcripts of oral testimony under this section shall transmit them to the custodian. The custodian shall take physical possession of such material, answers, or transcripts and shall be responsible for the use made of them and for the return of documentary material under paragraph (4).

(B) The custodian may cause the preparation of such copies of such documentary material, answers to interrogatories, or transcripts of oral testimony as may be required for official use by any false claims law investigator, or other officer or employee of the Department of Justice, who is authorized for such use under regulations which the Attorney General shall issue. Such material, answers, and transcripts may be used by any such authorized false claims law investigator or other officer or employee in connection with the taking of oral testimony under this section.

(C) Except as otherwise provided in this subsection, no documentary material, answers to interrogatories, or transcripts of oral testimony, or copies thereof, while in the possession of the custodian, shall be available for examination by any individual other than a false claims law investigator or other officer or employee of the Department of Justice authorized under subparagraph (B).