

# Law & Economics of White Collar Crime

Prof. Sandeep Gopalan  
Head, Dept. of Law,  
National University of Ireland, Maynooth

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# White Collar Crime

- Edwin Sutherland defined white collar crime as "a crime committed by a person of respectability and high social status in the course of his occupation" (1949).
- Crime in the streets v crime in the suites
- As of yet, no one in Ireland who has been prosecuted of white collar crime, has been imprisoned.
- Popular opinion that the law is too lenient on white collar criminals

# Introduction

- Jeff Skilling of Enron- 26 years
- Bernie Ebbers of Worldcom - Convicted and sentenced to 25 years imprisonment
- Joseph Nacchio of Qwest - Convicted on nineteen counts of insider trading and sentenced to six years in prison and to pay \$19 million in fines
- Bernie Madoff - convicted and sentenced to 150 years imprisonment
- Creeping criminalization of conduct that was traditionally dealt with by other areas of the law
- Sarbanes-Oxley Act of 2002

# Definition

- “semi-professional” or have
- “special technical and professional knowledge.”
- Do all defendants have professional or semi-professional status?
- Special skills

# Definition

- 1981, the United States DOJ: “[n]onviolent crime for financial gain committed by means of deception by persons whose occupational status is entrepreneurial, professional or semi-professional and utilizing their special occupational skills and opportunities; also, nonviolent crime for financial gain utilizing deception and committed by anyone having special technical and professional knowledge of business and government, irrespective of the person’s occupation.”

# Cost Implications

- Jail is costly: direct expenditures by federal, state, and local governments on corrections in 2006: \$68.7 billion
- Combined criminal justice expenditures: \$214.3 billion

# Cost (cont'd)

- Creeping criminalization has serious ramifications:
- Undermines the coercive power of criminal law
- Dilutes its expressive power
- Over-deters otherwise desirable activities
- Conflates blameworthiness with imprisonment
- Incentives for prosecutors to abuse powers
- Fuels an appetite for enhancing prison terms
- Increases social costs

# Introduction (cont'd)

- Analysis limited to agency offences
- Intersection of risky behaviour and morally wrongful behaviour
- Moral blame must be disentangled from punishment
- Criminalization does not automatically entail imprisonment
- Objectives of punishment achieved under deterrence, retribution, incapacitation, and restorative models



# Introduction (cont'd)

- sub-set of white-collar offenders – corporate fiduciaries abusing the principal-agent relationship
- inherently asymmetric
- Agents make up gaps in expertise, skill, and time that prevent principals from accomplishing the delegated tasks
- Company: collectivization of the principal creates incentives for free-riding and rational apathy

# Claims

- Yield significant savings by reducing prison costs.
- Allows state to take advantage of the disproportionate cost/burden of conviction on agency offenders
- Deterrence can be achieved at lower cost by conviction alone
- If cost of incarceration is the same for offenders with different earning capacities, imprisoning those with very high earning capacities is a waste of social capital if objectives sought to be achieved by incarceration can be achieved via other means

# Claims

- Cost of a conviction can be predicted with sufficient certainty in the case of white-collar criminals (earnings history)
- Contra common criminals, this loss ought to serve the deterrence function without the need for jail

# Agency Offences

- Criminalization of the principal-agent problem
- Justified?
- May be justified if conduct is morally blameworthy
- What if it is merely risky?
- Consensual harm? Caveat investor?
- Many regulatory offences may not involve moral blame

# Agency Offences

- Harm: suffered not only by the principal
- Economic harm from agency offences might be far greater than street crime
- Permissible to criminalize harmful white-collar conduct even if it is not morally wrongful
- Bodily harm and social harm
- Is imprisonment necessary to prevent harm in agency situations?

# Model

- Rational actor will trade off the expected value of committing the criminal act against two variables:
  - 1. probability of being caught
  - 2. punishment after conviction.
- If probability of being caught is low, criminal act might confer value even if the punishment is high.
- Same if punishment is low and probability is high.

# Model

- These 2 variables are a function of state resources
- Scholars in the economics tradition focused on disutility of punishment
- I focus on disutility of imprisonment
- Probability of conviction is  $p$ , the length of imprisonment is  $l$ , and the total disutility is  $u$ .

# Disutility of imprisonment

- Total disutility is made up of disutility of conviction  $c$  and disutility of imprisonment  $i$ .
- $u = p \times [(l \times i) + c]$ .
- Individuals with a high value for  $c$  are reputation conscious and those with a low value for  $c$  are reputation-indifferent



# Disutility Analysis

- Probability of conviction is 10 percent, the disutility of conviction is 200, and the disutility of any sentence length is 5, and the sentence is 10yrs. Then total disutility is  $.1 \times [(5 \times 10) + 200] = 25$
- Increasing the sanction to 20 years will increase the total disutility to  $.1 \times [(5 \times 20) + 200] = 30$
- If disutility of any sentence length is 0, then total disutility is  $.1 \times [(0 \times 10) + 200] = 20$ .
- Increasing the sentence length to 20 does not alter the total disutility at all ( $.1 \times [(0 \times 20) + 200] = 20$ ).

# Reputation Indifferent

- Probability of conviction is 10 percent, disutility of conviction is 0, disutility of any sentence length is 5 and the sentence is 10 years. Now total disutility is  $.1 \times [(5 \times 10) + 0] = 5$ .
- Increasing the sentence length to 20 years results in a total disutility of  $.1 \times [(5 \times 20) + 0] = 10$

# Reputation Indifferent

- State can achieve the same disutility for this individual as the offender with the disutility of conviction of 200 and no disutility of imprisonment only by imprisoning him for 40 years!
- Conversely, offender with disutility of 200 on conviction but no disutility on imprisonment can be deterred to the same extent even by saving money on prison costs for 20 years.

# Disutility of conviction

- Sending both kinds of offenders to jail for the same length is a waste of resources
- Disutility of conviction is hugely significant
- Destroys earning capacity, disqualifies from positions of trust...
- Sanctions can be combined to maximize disutility of conviction alone
- Information costs are low

# US: Some sanctions

- Offender is lawyer: bar license
- SEC can suspend him from practicing before it
- CEO of a company: demit office (Martha Stewart)
- Sarbanes-Oxley: section 1105, SEC has the power without going to court to issue officer and director bars as part of a cease-and-desist proceeding
- Standard for a bar is unfitness

# Sanctions

- Disgorgements
- Clawbacks: SEC v. Cavanagh, 445 F.3d 105, 117 (2d Cir. 2006)
- Section 304 Sarbanes-Oxley Act:  
accounting restatement due to material noncompliance: CEO & CFO to reimburse for--(1) any bonus or other incentive-based or equity-based compensation received by that person
- (2) profits realised by sale of shares

# Sanctions

- *SEC v. Sands*, 142 F.3d 1186; 1998 U.S. App. LEXIS 8093: equitable powers to compel disgorgement
- Revoking registration
- Consequential sanctions
- Dismissal from boards

# Conclusion

- Imprisonment is a waste of resources
- Objectives of punishment can be achieved at lower cost
- Variety of non-imprisonment sanctions available
- Can be more finely calibrated