

**TOO RICH TO REGULATE:
EXAMINING THE BARRIERS TO THE
USE OF SURVEILLANCE IN CORPORATE CRIME**

by

Nancy Zhang

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Abstract

Surveillance has long been used as an enforcement tool to detect conventional crimes and identify and punish offenders. However, its watchful gaze has been strategically directed away from the area of corporate crime. Corporate crime has long been under-studied and under-researched, despite the fact that the damages it causes amount to millions, even billions, of dollars. Its omission from the surveillant gaze, however, has been no accident. Because corporate offenders hold higher positions in society and possess greater political and economic resources than conventional street criminals, corporate offenders have often been able to resist the regulatory attempts against them. This thesis explores the underuse of surveillance as an enforcement tool in corporate crime, but also examines the regulatory climate that perpetuates this. It explores the main tools for addressing criminal and regulatory violations that are used by law enforcement agencies charged with enforcing corporate crime. This thesis identifies and examines five barriers—cultural, political, economic, legal, and technological—that have acted to limit and even prevent surveillance as a tool of regulation against corporate crime. Through an analysis of academic literature and public sources, this thesis assesses the small number of initiatives where surveillance strategies have been attempted in the field of corporate crime and investigates the reasons the attempts have been limited in number, scope and effect. The aim of this thesis is to draw attention to underuse of surveillance in corporate crime and question the current regulatory framework.

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Table of Contents

Abstract	ii
Acknowledgements	iii
Table of Contents	v
List of Figures	vii
Chapter 1 Introduction	1
Theoretical Perspectives	5
Methodology	10
Chapter 2 Literature Review	14
Introduction.....	14
White-collar crime: History, definitions and theories.....	15
Financial Crimes	22
Changing attitudes on corporate crime	25
Enforcement of corporate crime	27
Changes in government intervention.....	28
External controls: Regulators and law enforcement agencies	30
Internal controls: Self-regulation.....	33
Surveillance	35
The history of surveillance	36
Surveillance in use.....	39
Conclusion	42
Chapter 3 Dominant Tools of Surveillance Used in Corporate Crimes	44
Introduction.....	44
Who has enforcement powers?	46
The Securities and Exchange Commission.....	47

The Federal Bureau of Investigation	56
Enforcement tools in current use	60
Surveillance in corporate crime: Three examples.....	63
The New York Stock Exchange Pilot Program	64
The SEC's Market Abuse Unit.....	69
Wall Street and Wiretaps	73
Wiretapping as a surveillance tool	75
Conclusion	78
Chapter 4 Barriers to the Use of Surveillance in Corporate Crime.....	80
Introduction	80
Section I: Cultural Barriers.....	83
Section II: Political Barriers	90
Section III: Economic Barriers.....	98
Section IV: Legal Barriers.....	101
Section V: Technological Barriers	107
Conclusion.....	112
Chapter 5 Conclusion.....	113
References.....	118

List of Figures

Figure 1: The SEC Enforcement Process.....	52
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Chapter 1

Introduction

For every major financial crisis that has struck our globe, somebody somewhere has profited. At the root of all financial scandals there has been a person—an executive—a group of executives, or an entire corporation that has benefited from what are often manipulative and abusive acts. At times these individuals are blamed for the scandal, accused of having greed and hubris. Although these scapegoats are not entirely free from blame, this thesis supports an alternate argument that greater systemic factors are in play.

I became interested in the area of white-collar crime toward the end of my undergraduate business degree. It was introduced to me in an elective course on deviance and opened my eyes to the seedy underbelly of the corporate world. Upon further research into the topic I was surprised to find out the amount of harm that white-collar crime caused in society. Amounting to millions, even billions, of dollars, white-collar crimes have a greater pool of victims than conventional crimes; yet this was the first time I had even heard of such damages, and in a sociology course no less. During my time in business school, corporate crimes were often only touched upon in textbook chapters and glossed over in class. Business ethics was offered as one course, which was not even a mandatory one. Often, the discussions in these classes surround what is, and is not, ethical, and issues of legality are left for the business law courses to debate. Yet ethics cannot be separated from legality. The common view that corporate crimes are *mala prohibita* (made illegal by statute) instead of *mala in se* (wrong in itself) is an ideological distinction shaped and sustained by powerful groups (Snider 2009). In my research, I found that many *mala prohibita* crimes, deemed only to be illegal because it was written

in “the rules,” in fact caused some of the greatest damage, costing investors and consumers millions of dollars. It was evident that although the damage was not always direct, it was causing greater harm to a greater number of people. I became interested in taking a critical perspective of business. Since capitalism and business cannot be ignored or eliminated, my belief is that businesses should at least act responsibly. Unfortunately, it had already become evident to me that there were other incentives at work. Although the criminological research in the area exists, white-collar crime is a greatly under-studied field compared to other types of crime. Through my earlier research on the topic, I began to see how white-collar criminals were prosecuted and sentenced, and noticed the differential treatment of the law as pointed out by Sutherland (1983). This prompted me to find out why.

When Edwin Sutherland coined the term “white-collar crime” he referred to the fact that our attention had been misdirected away from the middle and upper classes who were assumed to lack the potential to cause social harm. Given the influence that corporations and those who run them hold today, it is not difficult to see that those in powerful positions have significant impact on the rest of the public. In fact, it was Sutherland who remarked that “Corporations have been more successful in regulating the public than the public has been in regulating corporations” (Sutherland 1983: 201), indicating the great influence that corporations have into their own regulation.

This thesis is about surveillance however it also, necessarily, speaks of the greater category of regulation. As a tool of enforcement, surveillance has been employed in many domains to regulate subjects’ behaviours. Corporations are these subjects of regulation when speaking of corporate crime. Government and regulatory agencies attempt to control their behaviour through using the various enforcement tools available to them. For

this reason, this thesis looks at both the act of using surveillance in corporate crime and at regulation of the financial industry in general.

Surveillance studies in the area of criminology have focused on the disadvantaged classes that account for the majority of the occupants in prisons. Coleman, Tombs and Whyte (2005) have argued that strategies of surveillance have supported a narrow definition of harm that reinforces “the gaze down the social and political hierarchy,” (2512) while we ought to be scrutinizing the harms of the more powerful groups.

It is because such groups hold so much influence in our society that we must study corporate crime. Using their influence on politics and subsequently on law, corporate executives have managed to keep surveillance out of their boardrooms (Snider 2010). Unfortunately, this is where some of the key decisions take place, decisions that end up costing investors, consumers and tax payers millions of dollars. However, this form of theft, when it occurs, remains “unwatched” by the law enforcement agencies that are charged with protecting the interests of investors, consumers and taxpayers. In the meanwhile, surveillance cameras on the streets have grown in number to the point where every move and transaction we make is monitored and recorded (Lyon 1994). With this amount of information available, law enforcement can easily target the delinquent youth for vandalism or the impoverished thief for stealing. However, those who cause damage to the environment and steal from investors remain largely unwatched.

This thesis is an exploration of how and why surveillance as an enforcement tool has been little used to address corporate crime. Chapter 2 consists of a Literature Review that begins with an overview of white-collar crime (history, definitions and theories). This chapter then narrows the literature down to discussions of financial crimes and explores the changing attitudes on corporate crime and on government intervention in business.

The chapter then looks at the segment of the literature in surveillance studies that focuses on the current uses of surveillance to address conventional crime and monitor the workplace. The purpose of this Literature Review is to provide a background for the chapters to follow, and to reveal where the research is lacking in this area of criminological and surveillance studies.

In Chapter 3, I will explore the major law enforcement agencies involved in addressing corporate crime, looking closely at the structure of the agencies and how they carry out their duties through the enforcement tools available to them. Most significantly, this chapter analyses three examples that demonstrate the few instances where surveillance has been employed as a tool of enforcement by these law enforcement agencies. What this reveals is that surveillance, while commonly utilized as a tool to address conventional crimes, has been infrequently used when it comes to corporate crimes.

Chapter 4 will investigate why surveillance, and the larger issue of regulation, has struggled to be effective in the area of corporate crime. I have identified five barriers to the use of surveillance—cultural, political, economic, legal, and technological—which limit, or even prevent the use of surveillance as a regulatory enforcement tool. This chapter argues that corporate crimes are the result of large and complex systemic issues, not of one individual, the oft-mentioned “rotten apple in the barrel.” Financial scandals and crises are furthered by a corporate culture of competition and risk-taking, a system of favouritism by politicians, economic disparity between regulators and corporations, legal ambiguities written into legislation, and complex technological developments.

This thesis concludes with a discussion of the implications of studying surveillance in corporate crime and the direction in which corporate crime enforcement appears to be

heading. Because corporate crime will never be entirely eliminated, this thesis emphasizes the need to improve regulatory effectiveness despite the systemic barriers.

Theoretical Perspectives

This thesis argues that the use of surveillance in corporate crime cannot be understood using only one theoretical framework. Because it is such a complex area of study, I have used multiple theories showing the perspectives of regulators, government, academic scholars, media, and corporations to inform this analysis of corporate crime and the underuse of surveillance. However, the framework I believe offers the most explanatory power is critical liberal democratic theory, as used by Edwin Sutherland in 1939 and many subsequent scholars.

Before Sutherland's 1939 speech, what is now called white-collar crime was not considered to be crime at all; rather, it was ignored or generally accepted as part of standard business practice (Simon and Hagan 1999). Sutherland's (1940) article proposed that the middle and upper classes, who were assumed to lack potential for harmful and criminal behaviours, ought to have their unlawful actions examined as well. He, in fact, argued that corporations committed even more malfeasance than conventional criminals, at greater costs as well. Following Sutherland, scholars such as Coleman (1987) and Clinard and Yeager (1980, 2006) were among those who argued that individual people, groups and classes, and the influences upon them, should be studied to determine causes of corporate crime. For Coleman (1987) it is the presence of both appropriate motivation and opportunity that created the conditions for corporate crime to occur, whereas Clinard and Yeager (1980, 2006) attribute the causes to the "immensity, the diffusion of responsibility, and the hierarchical structure of large corporations" (43). Other theorists have applied theories used to explain lower class criminality to corporate criminals. For

example, Gottfredson and Hirschi (1990) attempted to use a “general theory of crime” to explain white-collar crime in which they claim that crime occurs because of a self-interested desire to pursue pleasure and avoid pain. Low self-control combined with a desire for short-term gratification could explain, in their opinion, both conventional crime and white-collar crime. Passas (1990) also attempted to apply Merton’s theory of anomie (in which there is a gap between goals and legitimate opportunity structures) to corporate crime by describing the relativity of goals for higher income executives. This revised anomie theory posits that executives are pressured toward breaking the law as a means to obtain even larger profits—that is, their goals change with their circumstances and wealth and prestige levels, and goals that would gratify a working class person no longer suffice. From more critical theoretical perspectives Glasbeek (2002), for example, has argued that theories directed at studying individual character flaws, such as Gottfredson and Hirschi (1990), direct attention away from the organizational culture, policies and practices that foster an environment which facilitates corporate crime. That is, such theories allow one of the major tenants of capitalism, the imperative of profit-maximization, to escape scrutiny as a cause of corporate crime.

Neo-liberalism has offered another lens through which to understand why and how capital accumulation and profit-making have stood as barriers to greater regulatory surveillance of markets. This perspective, which is critiqued in this thesis, emphasizes that the economic efficiency of corporations and stock exchanges should be the paramount values governing corporate crime enforcement. The rise of neo-liberalism as philosophy and policy has strengthened business resistance to regulation through its claims that the market is the best determinate of economic and social policy making, “since competition among rational, self-interested individuals will allocate resources

more efficiently than the government” (Soederberg 2008: 663). Thus privatization and deregulation have led to increased power for the corporation (Soederberg 2008). The corporate spokespeople and pro-business politicians reviewed here argue that the “offenders” in corporate crime should be (and have often been) left to their own devices (exemplified in the case of the NYSE pilot surveillance program discussed in Chapter 3). This perspective, which has been adopted by governments around the world, helps explain why surveillance of white-collar executives is weak. In essence, neo-liberalism provides insights into capitalist agendas and the motivations of corporations and stock exchanges. It also shows why self-regulatory mechanisms have been the preferred enforcement strategy.

As noted above, the theories that I have found to be most useful have come from the critical perspective. These theories help understand the enforcement and under-enforcement of corporate crime and the underuse of surveillance by looking at the role played by certain dominant elites. Critical theories originate in Marxist arguments that economic institutions in capitalist social orders are the dominant force shaping all other institutions (politics, religion, education). However, Marxist and neo-Marxist theories differ from critical liberal theories used here because for them economic institutions are primary. Consensus and other liberal democratic theories, on the other hand, (for example Durkheim (1893), Merton (1938), and Parsons (1937)) assume that power is distributed across all major institutions and that any of these can act independently.

Critical liberal democratic theory has been applied to my analysis of the underuse of surveillance to explain how privileged groups become dominant and as such shape the conceptualization of corporate crime and the use of surveillance (Coleman and McCahill 2011). This theory is rooted in the principles of “individual liberty, civic equality, popular

sovereignty, and government by the consent of the governed” (Netanel 2000: 407). A democratic government is viewed as an effective means of preventing tyranny by providing “the people” with the power to remove existing political leadership. Yet, the role of the public is still limited. According to Litchman (1969) “all versions of liberal democratic theory are rooted in the existence of the capitalist system and its distinctive maldistribution of power” (204). He claims that this theory’s “paramount function is to justify the distribution of property and power which permits a minority of men [*sic*] to exploit and dominate the lives of the majority” (170).

Critical liberal democratic theory is used in this thesis to update Sutherland’s original works on white-collar crime which drew attention to the differential implementation of the law. Sutherland (1944) attributed this differential treatment to three factors: the status of businessmen; the trend away from penal methods of punishment to non-penal methods (indicating a move toward a middle class); and the unorganized public resentment against white-collar crimes due to their complexity (Sutherland 1961: 50). In particular, he noted the “cultural homogeneity” of legislators, judges, administrators and businesspeople, in which businesspeople were respect and admired and therefore not seen by the former three as fitting the stereotype of “the criminal” (137). Despite critiques of Sutherland’s interpretation which allege that this assumes the existence of an egalitarian society in which all persons are equal under the eyes of the law and therefore are treated as such, Sutherland’s original theory (and this thesis) concludes that power is unequally distributed amongst members of society. In fact, this thesis argues for Sutherland’s (1944) theory: it shows that administrators of the criminal justice system are afraid to antagonize businessmen as they fear this will affect their power, status and particularly their campaign funding. Thus, as liberal democratic theory proposes, power is effectively

concentrated in the hands of a minority of people who exploit it for their benefit, to continue capital accumulation. My analysis uses this theory to reach similar conclusions as Sutherland originally did to explain why corporations are not put under intensive surveillance or sanctioned; that it is differential implementation of the law that has led to the wealthy and more privileged classes remaining relatively unwatched.

As this thesis will show, the economic elites who run financial capitalism wield influence over the laws that are, and are not, passed and influence how they are written. As Snider (2009) argues, corporations use their political, social, ideological and economic capital to shape the interpretation of these laws (189). Subsequently these privileged actors and groups have established surveillance as a tool used primarily to control less privileged groups. Instead of scrutinizing upward, surveillance has been cast “down the social and political hierarchy” (Coleman et al. 2005: 2512). Williams (2008) has described this as “the ability of powerful economic actors to undermine and circumvent the regulatory process by taking advantage of the ambiguity of law, actively shaping regulatory meanings and structuring their activities in a way that satisfies the letter while violating the spirit of the law” (311). This thesis will explore the differential distribution of power and economic resources as well. Thus embedded in the subsequent chapters, this perspective explains how and why powerful corporations can have a stranglehold on political parties and regimes and the effects this has on less powerful investors and consumers who are left to cope with the consequences of business actions.

The current landscape of surveillance is changing and, as this thesis will later discuss, since the financial crisis of 2008 there has been an intensified focus on the actions of the wealthy. Nonetheless, as Coleman and McCahill (2011) maintain, “new surveillance” technologies have very seldom been used to detect corporate illegalities

despite the fact that these technologies seem well-suited to monitoring and preventing corporate crime (Alvesalo, Tombs, Virta and Whyte 2006). However, Snider and Molnar (2010) (among others) have maintained that if regulators concentrate exclusively on a “technological fix” rather than questioning the economic order that makes corporate crime possible, this is equally short-sighted.

Methodology

Corporate crime research has long been understudied for many reasons. It is not an area of criminological study that allows easy access to its pool of potential criminals. Claiming that research into corporate crime is particularly difficult in a neoliberal era, Tombs and Whyte (2007) contend that “the inner sanctum [of the corporate world] is likely to be even more tightly sealed from outside scrutiny when the aim of the outside researcher is to investigate actual or possible illegality” (136). Primary research, through methodologies such as participant observation or interviews, would deliver a richer portrait of corporate practices, but it is rendered difficult if not impossible because of barriers to access. Given the potential for corporate espionage, corporations are reluctant to let outsiders in to observe their operations; they are also very wary about allowing researchers in to study potential fraud and abusive practices within their businesses. Thus researchers are frequently forced to rely on government inquiries (whose intrusions corporations cannot legally resist) and whistleblowers—even though both employees and employers are reluctant to “blow the whistle” so to speak, on their company and risk losing their jobs or other repercussions. Even if access is granted into a corporation, many of the crimes committed require specialized knowledge in areas of accounting and finance, and the average social scientist lacks training and education in these areas (Croall 2001). Furthermore due to the placement of gatekeepers at every hierarchical level of a

corporation (Tombs and Whyte 2007), gaining access to original documents—especially ones that are confidential in nature—is time consuming and extremely difficult if not impossible. Gaining access to the official enforcers of corporate crimes is easier, yet they too are often mired in bureaucracy that limits the research process (Croall 2001). All of these factors make primary research data extremely difficult to obtain. Empirical data on the incidence of corporate crime is difficult to come by as well, because standard police statistics do not cover many kinds of corporate crime, and “many white collar crimes are not dealt with by the police” (Croall 2001: 14). Where official statistics are gathered, the “dark figure of crime,” the gap between the number of crimes committed and those discovered and reported, is substantial.

Instead, this thesis conducts a secondary source analysis using publicly released government documents, media reports, corporate websites, scholarly articles and books. Due to the time and resource limitations of a Master’s thesis, secondary sources were the only practical way to obtain as fair an assessment as possible of the different ways this area of crime has been enforced and resisted. Furthermore, in my use of secondary sources, I attempt to gain insight into the multiple perspectives and viewpoints of the primary actors in this area. Naturally, the government documents examined have been thoroughly vetted and corporate releases are equally carefully crafted, both with a view to protect sources and maintain reputations. Additionally, media sources have their own biases, particularly because most are owned by large corporations or have political ties with dominant actors or special interests in the topics being reported. Aside from lack of objectivity many of their sources cannot be verified by outside researchers. Despite these limitations, I found government documents, news releases, and reports by investigative journalists to be the most widely accessible sources.

Through a secondary source analysis, this thesis focuses on the enforcement tools used by law enforcement agencies, and examines why and how they are or are not employed. This research has been done by literature searches of a number of sources. First the official enforcement manual of the SEC and official legal orders sanctioning the NYSE were found through the SEC website. The SEC website was also where a news release naming the Philadelphia branch's Market Abuse Unit as the SEC's primary source of market surveillance was found. A third example of surveillance use was found through the FBI's website, which provided an official press release from the U.S. Attorney's Office regarding the precedence-setting case of wiretap use for insider trading. It was an article written by Comerton-Forde and Rydge (2006)—where the pilot audio and video surveillance system that was imposed on the NYSE through SEC sanctions was mentioned—which prompted research into the surveillance system through official documentation. During this search, I was unable to find information on surveillance systems outside the standard algorithmic tracking systems employed as self-regulatory mechanisms by various stock exchanges' compliance and surveillance units. Furthermore, I came across the case of wiretapping initially through various news reports that claimed that this was the first case where it had been used against insider trading. This claim was substantiated through documents describing the legal battle that contested its use on the grounds that it would set precedent for law enforcement's future surveillance of corporate employees.

I have also conducted my research through a search of dominant newspaper websites such as the *New York Times*¹ and the *Wall Street Journal*², as well as one of the

¹ <http://global.nytimes.com/>

² <http://online.wsj.com/>

predominant providers of financial market data, *Reuters*³. All of these sources were backed up by literature reviews of scholarly research through books and journal articles. Although I recognize that white-collar crime scholars too have a bias, I have found a consensus among them that white-collar crime is both understudied and under-enforced. This study is apparently one of the first to study surveillance against corporate crime, since it has just come onto the scene as an enforcement tool.

By searching for and tracking the developments of surveillance through public media sources, I was able to determine how much attention, if any, was being given to surveillance as an enforcement tool. Subsequently, this informed my analysis on what barriers stood in the way of its use. In future studies on this topic, I believe that it would be worthwhile to pursue primary research on the use of surveillance in corporate crime. Despite the barriers to access, a first-hand examination of the actual technological tools, in combination with an ethnographic study of the various actors who use and are intended subjects of surveillance, would provide valuable insight into the effectiveness of regulatory tools.

The aim of this thesis is to draw attention to the underuse of surveillance in corporate crime. To conduct an analysis of why this is the case, we must first understand the history of corporate crime and its enforcement. This thesis therefore begins with a Literature Review on these areas.

³ <http://www.reuters.com/>

Chapter 2

Literature Review

Introduction

This Literature Review begins with a look at how white-collar crime has been defined since its classification less than a century ago. Using the theoretical perspectives described previously, this Literature Review provides a background through which the later chapters can analyse the barriers to the use of surveillance in corporate crime. It begins by looking at the many facets of white-collar crime that the original definition by Edwin Sutherland, who opened the door to the discipline, did not include. Specifically, this Literature Review will explore the arguments of critics who considered Sutherland's terms to be problematic and will follow the evolution of viewpoints on white-collar crime and the institutions that it affects. After exploring the definitions of white-collar crime, this Literature Review will look at the currently controversial area of financial crime, specifically securities fraud which has become a pervasive form of financial fraud in the current marketplace. It is here that I will examine how financial crime became a category of corporate crime, how it has been differentiated from other forms of corporate crime, and how it is both viewed and treated as an offence by those administering criminal justice, particularly police (within the financial sector, it is the regulators that do the policing), lawyers and the politicians who create the laws. I would be remiss to overlook the opinion of the public on white-collar crime as they, as voters, have impact on the legislation put in place by the government (although their influence can be somewhat overshadowed by the greater influence of large corporations—an issue I will elaborate on in Chapter 4). Next, literatures on enforcement will be reviewed, specifically in the area

of corporate crimes. To do so, I will examine the role of external controls, such as regulators, and internal controls, such as corporate transparency. Finally, a look at the field of surveillance studies is necessary to address the dominant issues this thesis will discuss, namely why surveillance is chosen as a tool in certain areas of crime control but is very little used for corporate crime. Surveillance has extended into nearly all areas of life, in particular focusing its attention downward on the poor and less powerful. In order to consider its use and potential for addressing corporate crime, it will be pertinent to examine the current uses of surveillance in everyday life, as well as its effectiveness as a tool against crime.

White-collar crime: History, definitions and theories

To understand how white-collar crime became what it is today, we must understand its history and how it came to be defined as it is. The history of white-collar crime begins long before the term was famously coined by Edwin Sutherland in 1939. It existed in the form of deceptions between traders of the early modern corporations; it was the scams pulled by early confidence men who preyed on the greed and naïveté of everyday folks who merely sought to make a living in hard times. Businesses deceived and manipulated other businesses to get ahead in the marketplace, giving credence to the cutthroat, profit-driven reputation that capitalism developed. The corporate empires of the late nineteenth century—Rockefeller, Vanderbilt, Carnegie to name a few—were themselves involved in bribery, fraud, and market manipulation, yet they were essentially untouchable by the arm of the law due to their high social status and the close personal relationships between many heads of corporations and heads of state (Friedrichs 1996). It is apparent that white-collar crime has been around for many centuries, though not necessarily by that name. Yet, those targeted by criminal law and those who occupy state and federal prisons were

still more or less the “street criminal.” When the stock market crashed in 1929 and the subsequent Great Depression occurred, it became evident that the poor did not have a monopoly on crime (Sutherland 1940). The consequences of the stock market crash impinged on other areas of life, and even those who had been uninterested in the market felt the reverberations. It became significant to be critical of the fact that there were large sums of money held by individuals and corporations, often the life savings of everyday citizens, which were the wagers in very risky business bets. Moreover, some businesses, for no greater reason than profit maximization, acted to manipulate and deceive their shareholders through fancy financial accounting and complex financial schemes (Shapiro 1984; Snider 1993; Clinard and Yeager 2006).

It was during his speech to the American Sociological Association in 1939 that Sutherland famously termed this phenomenon as “white-collar crime.” Until then, “blue collar crimes” (also referred to as “street crimes” and “conventional crimes” in this thesis) were the focus of the writings of academics and legal minds. Blue collar criminals, who were typically poor, accounted for the majority of the occupants in prison for “conventional” crimes (Clinard and Yeager 2006) such as theft, burglary and robbery, as well as assault, rape and murder. In fact, it was the crimes typically committed by the poor and less powerful at which most criminal laws were directed. Sutherland (1940) proposed that scholars ought to examine the unlawful actions of those with higher socio-economic status, the middle and upper classes (the “white-collar workers”) rather than assume they lacked the potential for harmful and criminal behaviours. Accordingly, his definition of white-collar crime described it as “all offences committed by a person of respectability and high social status in the course of his occupation” (9). His own research, conducted through studying the corporate violations of seventy corporations,

found that corporations committed as much, if not more, malfeasance than conventional criminals, and their offences cost millions of dollars more than “conventional crimes.”

Sutherland received much criticism for his original definition for being too broad as well as for being too vague. Among white-collar crime scholars, Hazel Croall (2001) is one who finds difficulty defining “high social status” and specifying what “respectable” means in reference to occupation. As such, she prefers Sutherland’s later elaboration on his definition that an “abuse of trust inherent in an occupational role” (14) is necessary to what we call white-collar crime. While Sutherland was satisfied with considering behaviours that were punishable by law white-collar crime, Paul Tappan argued that this unfairly labelled corporations and individuals as white-collar criminals when they had not been properly processed through the criminal justice system. As most corporate offenders had never been near the criminal justice system, their acts were not, from a strict legal definition, classified as “crimes.”⁴ Sutherland noted that the law was differential so that higher status offenders were treated more leniently than lower-class offenders. In fact, corporate executives only reached conviction in criminal courts if they employed similar methods to those used by the lower socio-economic class (Sutherland 1961). Sutherland attributed this differential implementation towards white-collar criminals to three factors: the highly regarded status of businessmen in society; the trend away from penal methods of punishment to non-penal methods such as probation (indicating a move toward a middle class); and the unorganized public resentment against white-collar crimes due to their complexity (Sutherland 1961: 50).

⁴ This began the infamous Sutherland versus Tappan debate on the definition of crime in general. By Tappan’s definition, only those crimes that had been filtered through the criminal justice funnel (a process through which crimes are filtered out as they travel through the criminal justice process, leaving fewer crimes to be tried and fewer offenders to be prosecuted) and had experienced the due process of criminal law could be labelled as “criminal.” Sutherland argued that violations in civil or administrative law were sufficient for that label without process by criminal law (Snider 1993; Salinger 2005).

Although many have tried, there has been difficulty with assigning one all-encompassing definition to white-collar crime. However, most contemporary definitions include some combination of the following characteristics as described by Coleman:

(1) they are offences committed as part of a lawful occupation; (2) a violation of trust is involved; (3) there is no direct physical force, although physical harm may well result; (4) the goals are money, property, power, or prestige; (5) there is a specific intent to profit by the act; and (6) there is an attempt to conceal the crime or use power to prevent the application of sanctions. (Coleman 1985: 5)

Before continuing in this discussion on white-collar crime, it is necessary to distinguish between occupational crimes and corporate crimes, both forms of white-collar crime. To differentiate between the two, one must determine who benefits from the offence and who is victimized. Occupational crimes are committed by an individual within the firm *against* the corporation for personal gain, leaving the corporation at a loss of profits, resources or opportunities; thus the corporation is the victim. Corporate crimes are defined as those committed by individuals working *for* organizations with the intention of furthering the interests of the corporation as well as their own (Clinard and Quinney 1973; Snider 1993). The victim in corporate crimes may be the consumer, taxpayer, investor, employees, or other businesses. Edelhertz (1970) adds to this classification by naming corporate crime as “crimes incidental to and in furtherance of business operations, but not the central purpose of the business” (6). The underlying rationale often used to justify corporate crimes, which will be criticized in thesis, is that such crimes are *mala prohibita* (made illegal by statute) rather than *mala in se* (wrong in itself even in the absence of a law making it illegal)(Croall 1992). Thus, the justification is that acts committed by corporations are only considered to be “illegal” because they are deemed as such by a governing body, not because they violate any moral code. To this, Snider (2000) has argued that this distinction between illegality and moral wrongfulness

is an ideological one, shaped by powerful groups such as business and law. In fact, I will argue that most corporate crimes result out of standard business *habitus*, which is perpetuated by powerful groups into society as “common sense.” With these “common sense” notions of business in place, those who make the laws therefore deem anti-business and anti-competitiveness in the marketplace as violations of law rather than condemn any morally objectionable actions committed by business (Friedrichs 1996; Rosoff, Pontell and Tillman 2004; Day, Girard, Snider, and Watters 2009).

When theorizing about the roots of white-collar crime, it is worthwhile to note the distinction between perpetrators of white-collar and non-white-collar crimes, especially as the perpetrators have different levels of influence on law passage and enforcement. In particular, the two types (presuming for the sake of this argument that there are only two types) vary greatly in socio-economic backgrounds, education and achieved status in the workplace. Although this division is simplistic, it is worth noting because, as discussed later, the ratio of lower level employees against upper level employees who are under surveillance is very high (Ball and Wilson 2000). In general, white-collar criminals are seen to be highly educated, to come from what Sutherland and his successors generally refer to as a “respectable” class, and have what is prominently seen as “high social status.” Thus white-collar crimes could not be explained by many of the socio-economic theories used for “traditional” forms of crime. For example, consensus theories—often used to explain deviant behaviour by drawing attention to the socialization of people into society—could not predict corporate crime because wealthy and successful people were viewed as being properly socialized and thus, according to consensus theory, could not commit crimes. Croall (2001) offers general theories of crime that have attempted to explain corporate crime. “Rotten apples in the barrel” blames individual “rotten apples”

for the wrongdoings, citing individual afflictions which are unique exceptions to the collective, as the cause. However Glasbeek (2002) argues that this theory tends to divert attention from the “barrel” which consists of the organizational culture, policies and practices that create the conditions for corporate crime. Alternatively, “the buck stops here” is a theory that sees organizations as inherently criminogenic due to the diffusion of responsibility offered by its structure and cultures of profit maximization that encourage making money through any means possible. For the purposes of this thesis, I will focus on the latter theory about the culture of profit maximization to get at the root of corporate crime.

Since traditional socio-economic factors cannot be used to explain these offences, Braithwaite (1989) and Snider (1993) take a psychological and an organizational level-perspective, arguing that crime is a product of both individual psychology and sociological factors, such as a work environment, that are conducive to committing crimes. This is particularly true of corporate crimes since access to crime can only be obtained through certain positions within a corporation, and it is within these corporations that offenders find the opportunity to commit their deviant acts. Coleman’s (1987) theory of white-collar crime concurs and is rooted in the hypothesis that criminal behaviour is based on the presence of both appropriate motivation and opportunity. Psychology states that motivation to offend is affected by the demographics of the offender as well as the subjective availability of the offence; that is, whether the offender perceives there to be access to the crime (Snider 1993). At a macro-level, white-collar crime is argued to be a by-product of the environment of “profit maximization at all costs”—what many critics consider to be a major flaw, yet a defining feature, of the capitalist system. Specifically they argue that it is the nature of capitalism itself that creates an environment for

corporate deviance. Glasbeek (2002) contends that “Capitalism’s strongest argument is that the accumulation of wealth for its own sake is a worthwhile economic and, therefore, meritorious social and political goal” (17). The defenders of capitalism claim that overall economic efficiency is a result of capitalism, which benefits the overall good, and thus justifies greed and inequality that characterizes it. Historically, the state not only allowed, but encouraged capitalists and entrepreneurs to use the most efficient means they could to accumulate as much money and power as possible. Selling stocks became one of those means to raise money for further capital pursuits, and thus was seen as intrinsically a “good thing” (Snider 2009). With the accumulation of wealth through capitalism came the accumulation of power, and with this power certain groups were able to influence and shape the law to reflect their own interests. Sutherland himself noted this fact. He pointed out that certain groups with power, who were involved in the law-making process, were able to determine what was to be included or excluded within the law. The intrinsic harmfulness of the behaviour in question thus was not a significant factor in writing laws as influential groups sought to maintain their power. In effect, Sutherland had identified a dynamic that is now widespread across laws affecting white-collar crime: that groups in power that make the laws faced pressures from the very subjects they were trying to regulate.

In identifying corporate crime, the importance lies in defining it separately from what are considered “normal” business practices. Over time, the groups who have more influence change, as do the power relations between business and government (Bauer, Pool and Dexter 1972; Braithwaite and Drahos 2000). Violations of corporate laws can often remain undetected for long periods of time, during which the acts may even become standard business practice (Simon and Hagan 1999). As such, those who choose not to

partake in violations are then judged to be disadvantaged through being unable to compete. Thus corporate crime not only victimizes consumers but competing businesses as well. White-collar crime as a whole is seen as a category of crime that is both difficult to identify and difficult to detect. For one thing, it is a crime in which the identity of the victim is often unknown to the offender, particularly if the offender is a large corporation that has a large pool of clients and investors at its disposal. Secondly, victims may not recognize that they are victims of an offence, and when they do, there are often limited options for restitution. Thirdly, the corporations that have clout can, and do, use their power and size to hide violations and impede enforcement (Sutherland 1940).

Consequently, there remains a “dark figure” of corporate crime that cannot be determined since, *ceteris paribus*, the amount of crime detected and processed increases with the number of crime watchers (Snider 1993). As a category, corporate crime has evolved in a number of areas and into complex frauds affecting entire markets, perpetrated by those who were in positions of power and influence. With globalization and increased communication, thanks to advancements in technology, the distribution of information and the potential impact of corporate crime have reached further than it has in the past. Through this dissemination of information, the impact of corporate crime is now more global than it has been before as decisions made in the United States, for example, now have impact in markets overseas, and actions in foreign markets have a ripple effect all the way in North America.

Financial Crimes

As discussed above, corporate crime has been broken down into various “typologies” based on the type of harm that it causes: financial, physical, or moral (Snider 1993). Financial crimes will be the focus of this thesis. Financial crimes use deceit,

concealment, or a violation of trust in order to commit acts of fraud, theft or embezzlement so that individuals or organizations can obtain a personal or business advantage. They are usually not dependent upon the threat or application of physical force or violence. Financial regulation against these crimes is predominantly aimed at protecting the integrity of the exchange systems rather than catching and punishing individual offenders (Cranston 1982). Dividing the category of financial crimes down further, I will focus on securities fraud which has become a popular subject of controversy and subsequently the frequent target of legislation. It is an offence that is generally committed against investors, one that involves deception and manipulation on the part of the offenders. Securities fraud can involve misstatement of financial reports, insider trading⁵, front running⁶ and a range of other activities that can occur on the trading floor or within the walls of an investment bank, all with the view of gaining corporate and/or personal profits and/or avoiding corporate and/or individual loss (Rosoff et al. 2004). As securities fraud can take place within a perfectly legitimate business, so too can it be perpetrated by an individual or a group of individuals through a purposely fraudulent business, one set up with the specific intent to defraud investors. Ponzi schemes⁷ are an example of this. Ordinary citizens who find their savings, their mortgages and their pensions tied up in securities, may find themselves to be the unsuspecting victims of securities fraud. Furthermore, the experts and professionals who manage money are in positions of influence; their daily work providing them with ample opportunities to violate the trust of their clients. Not only do these professionals have large sums of money

⁵ Insider trading is the buying or selling of a security based on non-public information (SEC 2010a).

⁶ Front running occurs when an analyst or broker trades on information for his or her own benefit before the information has been given to his or her clients (McCann 2000).

⁷ A Ponzi scheme is an investment fraud that pays existing investors with funds contributed by new investors. Instead of actually investing the funds, the organizer often uses the payments for personal expenses (SEC 2010b).

entrusted to them but their jobs encourage them to take greater risks for the chance at greater rewards.

Within the past decade securities fraud has become the focus of regulators and legislators. In the public news, more securities frauds have come to light—and have produced greater losses—than ever before (Heenan et al. 2010). This particular type of crime has once again become a focus of recent government legislation in light of the 2008 financial crisis that affected the global economy. It has since come to the attention of governments that large firms play risky games, betting on and against volatile markets with huge sums of money that are not their own. Adam Smith once declared that it was easier for managers to gamble with someone else's money than their own (Swedberg 2003: 76). Investment firms, in particular, have demonstrated certain carelessness when gambling with other people's money. With bonuses tied to stock options, traders have been prone to take larger risks than necessary since their stock positions allow, for example, for large gains to be made if the stock goes up, and little to be lost if it goes down (Black 2010). This will be further discussed in Chapter 4. In an example, Goldman Sachs recently demonstrated particular carelessness in this area when they created mortgage-backed collateralized debt obligations (CDOs), sold them to investors, and subsequently took a short position⁸ against them. The result was a loss of billions of dollars for investors and a civil suit by the SEC against Goldman Sachs and the trader implicated in this case, Fabrice Tourre (Story 2010; Barr 2010; McKinnon 2010). As they have done in the past following a major financial scandal, governments have consequently acted to curtail this recklessness. This will also be further explored in Chapter 4.

⁸ Taking a short position means betting on the decline of a stock's value (SEC 2010c).

Changing attitudes on corporate crime

Throughout the 1980s and 1990s, CEOs and traders acquired the status of rock stars in many—particularly business—media. In their rise to the top, they have graced the cover of magazines (such as *Time* and *Forbes*), been named in the top of their field, praised for their business acumen and presented awards for their leadership and vision. Scholars have depicted the corporate criminal as possessing a personality of the “self-confident” and “risk-taking” sort, and have found such qualities to be common and even necessary among successful businessmen (Fenton-O’Creevy, Nicholson, Soane and Willman 2005; Knee 2006; Zaloom 2006). To demonstrate this, a recent study (Kaplan et al. 2009) on MBA students who are also working professionals found that many students did not view insider trading by chief financial officers as unethical.

Cullen, Hartman and Jonson (2008) distinguished three stages of transformation in public sentiment against white-collar crime. In the first stage, before 1970, there was relative inattentiveness to white-collar crime. Any attention that was paid to these offences only demonstrated that these offenders were beyond the reach of the criminal law. Not only were those with power “able to deflect the criminal law from attacking their interests” (33) but on the part of the public, there was general ignorance as they too struggled to define it. With the exception of greater public condemnation toward crimes in food and drug safety, “upperworld criminality” was treated with general apathy by the public and while “[p]eople might be outraged episodically by revelations of an egregious scheme or scandal...they did not see such lawlessness as endemic to the nation” (Cullen et al 2008: 33).

Cullen et al. (2008) described the 1970s as the era of the growing prevalence of investigative journalism. With this, instances of white-collar malfeasance were highly

publicized rather than hidden as they had been in the past, allowing greater insight for the public into the actions of those “upperworld” actors (38). Many scholars worried that the public apathy of the early postwar decades was a barrier to the control of “upperworld lawlessness” since it would hinder any policy decisions to bring white-collar offenders within the reach of the criminal law (Conklin 1977; Sutherland 1983; Cullen et al. 2008). This led to the second stage of transforming viewpoints on white-collar crime, the period between 1970 and 2000, where Cullen et al. (2008) saw a shift in public awareness and willingness to sanction “upperworld lawlessness” (33). As a part of this shift, there was a dramatic change in the public’s conceptions of “acceptable” risk, and acts that caused physical harm due to lax standards or corporate negligence fell into the category of unacceptable. The anti-business sentiment during this era was driven by the “confidence gap” or “legitimacy crisis” that increasingly damaged the trust in government and in other major social institutions including businesses (Lipset and Schneider 1983). In the United States this could be traced back to government lies and deception during the Vietnam War, the Watergate crisis (that led to the forced resignation of Richard Nixon), and a rash of health-threatening environmental disasters such as Bhopal and the Love Canal (Snider 1993). By the 1980s, the common public assumption was that corporations would only act in a socially responsible manner if it was in the corporation’s best interest.

The third stage recognized by Cullen et al. (2008) takes place from the year 2000 to present times, where white-collar offenders have been depicted as “bad guys.” In this stage, which would become the era of several corporate bankruptcies and financial scandals, there came a decline of confidence in businesses accompanied by an increase in the call for justice to be equally applied to all classes of offenders. “This confluence created a special problem for the government. For the state to protect its own declining

legitimacy, it had to show a concerned public that it was not beholden to corporate interests” (Cullen et al 2008: 38).

Along with this change in attitudes on corporate crime came a change in the enforcement structure as over time, government has increased or decreased the resources assigned to law enforcement agencies to combat these offences. The next section will look at enforcement in the area of corporate crime and how changing attitudes and ideologies regarding government intervention have subsequently affected how corporations have internally and externally been regulated.

Enforcement of corporate crime

The general category of enforcement encompasses too many areas and too many perspectives to receive the detailed treatment it deserves here. Instead, I will focus only on enforcement in the area of corporate crime and in later chapters demonstrate how this has occurred (or not occurred) through an assessment of the tools of surveillance. Important to this discussion is the ongoing debate on government intervention and how much the government should “interfere” with corporate agendas in order to control the marketplace. Scholarly positions on government intervention have changed over time, fluctuating cyclically between periods of high government intervention followed by a period of low intervention. Moreover, it is argued that the areas of business in which governments have chosen to intervene often reflect political agendas, agendas influenced by special interest groups or powerful corporate figures. Snider (2009) has linked government and regulatory intervention in the marketplace to the cycle of economic crises which prompt governments to tighten regulatory restrictions, only to have them fall short by the time the next crisis hits. This will be further explored as I examine how government intervention has led to pressure on regulators, both external and internal.

Changes in government intervention

In the 19th and for much of the 20th century, western governments have been reluctant to interfere in the marketplace, facing opposition from mainly large corporations whenever they attempted to intervene. As the early stock exchanges were private money-raising institutions, state and federal laws were reluctant to step in and impede their contributions to economic wealth. For this reason, they were primarily self-regulated; that is, until the market was hit by a series of financial scandals in the early twentieth century (Braithwaite and Drahos 2000). Until the market crash of 1929, securities regulation in the U.S. took the form of “blue-sky laws” where the responsibility of governing the stock exchanges was left to the individual states. After the crash, the federal government stepped in with its earliest official securities laws, the Securities Act of 1933 and the Securities Exchange Act of 1934, which created the centralized federal regulatory system that we see today (Geisst 2004).

At the same time, in the marketplace, it has been the dominant belief of large firms, and laissez-faire capitalists, that the market should not be interfered with; that a free market should be free from government regulations so that the market could function efficiently. At the start of the neo-liberal era, it was strongly believed that only the market could efficiently allocate resources, not managers and certainly not government bureaucrats. This era of “downsizing and privatization” was marked by an expansion of competition policy and demonstrated the government’s shift to a system of “minimum intervention and maximum reliance on market forces” (Anderson, Hollander, Monteiro and Stanbury 1998: 180). In the volatile stock market, those who subscribe to the

efficient-market hypothesis (EMH)⁹ believed that stock prices would reflect the information that was available in the marketplace. Unlike violations of competition policy, government involvement was deemed less necessary in stock markets. Although little government interference was promoted by market actors, eventually the need to maintain fairness in trading required government action. Acts such as insider trading became the targets of recent legislation (such as Bill C-13 in Canada¹⁰), designating it a criminal act with criminal consequences. Although insider trading arguably does little physical harm, it causes financial harm and its penalty carries a prison sentence. The act of insider trading often benefits a single investor, or small group of investors, along with the trader or broker carrying out the deal. Because the victims of this offence are not only the other investors, but the corporation as well, governments have criminalized this act to ensure fairness in the marketplace and protect the value of corporations. In this case, we can see how the corporations have gained from government intervention.

Due to a number of factors—not the least of which is the close interpersonal relationships between top government officials and corporate executives, not to mention a “revolving door” (which will be described in Chapter 4) between government and private industry—governments have been notorious for dragging their feet on passing and implementing legislation that restricts business operations (Alderman 2007; Soederberg 2008).

⁹ Supporters of the EMH claim that stock prices have built within them both public and non-public, or inside, information (Ross, Westerfield, Jordan and Roberts 2005). Thus the market was seen to operate at maximal efficiency only when government “interference” was minimized.

¹⁰ Bill C-13 was passed on February 12, 2004 and in addition to criminalising improper insider trading, it doubled penalties for ‘market manipulation’ and made tipping an offence. Transparency was required of banks and whistleblower protection was strengthened (Snider 2009).

External controls: Regulators and law enforcement agencies

Corporate crimes, particularly financial crimes, have been given relatively little attention by traditional criminal justice systems and their front line enforcement agents, the police, compared to the more traditional street crimes. Marked by their complexity, police have a poor track record of arrests and prosecutions with regard to corporate crime cases, due to investigative officers' lack of knowledge of the complex legal and economic details of such cases, as well as being bound by legislation, or lack thereof, to pursue these cases (Cullen et al. 2008). Consequently, most of the regulation of markets and businesses is assigned to either state/provincial or federal regulators, who act as “the police” of the corporate domain—albeit with very different rationales and powers than “regular” police. On a daily basis, corporations are not patrolled by the law enforcement agencies that police ordinary citizens and the individual employees of the corporations. Further obscuring the enforcement of corporate crimes, Friedrichs (1996) draws attention to the complex and ambiguous jurisdictional boundaries that surround white-collar crime cases. In the United States, white-collar crime falls under the investigative jurisdiction of over two dozen separate federal agencies, among which are the Inspector General, the U.S. Customs Service, the Internal Revenue Service Criminal Investigative Division, and two agencies that will be discussed in Chapter 3, the Federal Bureau of Investigation (FBI) and the Securities and Exchange Commission (SEC) (Pence 1986; Friedrichs 1996).

The reason corporate crime enforcement appears to be lagging behind conventional crime enforcement lies in a number of factors. One is historical: for decades police forces have paid little or no attention to white-collar or corporate crimes. Focused on the capture of the so-called dangerous class of criminals, the crimes of the wealthy were frequently

overlooked or ignored. With police resources dedicated to combating conventional crimes, government and non-government regulatory agencies were created to handle “upperworld” crime. This exacerbated the problem of differential treatment of white-collar crimes versus traditional crimes not only within law enforcement agencies, but also among those who prosecute these offences. Subsequently, the legal system’s own treatment of corporations under the law has historically permitted, knowingly or unknowingly, corporations to continue with their offences. To further complicate this point, scholars have often used the phrase “regulatory violation” instead of the discourses of criminality to describe these offences, an example of the way in which corporate crime is able to escape the stigma of other criminal activities (Sutherland 1944). In comparison to more traditional, or conventional, crimes, corporate crimes receive less police resources (Lichtblau, Johnston and Nixon 2008; Quick 2010). Thus, fewer corporate crimes are uncovered and prosecuted, and those that are receive lighter sentences than conventional crimes (Gray 2007; Benediktsson 2010; Coleman and McCahill 2010). In part this is due to politics; that the government and its legal arms prefer to, and are lobbied to, stay out of business affairs. In greater part, this is due to the fact that regulators initially take the reins in the investigation of a corporate offence, and generally they prefer to resolve the case through civil and/or administrative action. It is often only when regulators refer the matter to criminal investigation agencies that corporations may face criminal law.

The law-makers, who create the regulatory environment by passing legislation, have softened the language of corporate criminalization by transforming policing entities into “regulators” and subjects of regulation, known in conventional crimes as the “offender,” have become the “stakeholders.” Glasbeek (2002) further notes that the role

of regulators has changed to one of helping corporations comply with standards, rather than strictly policing them. In addition, commentators on regulatory enforcement have noted that policing in this area by regulators has utilized large amounts of negotiation and discretion (Frank 1984).

The role of day to day monitoring of securities transactions has been assigned by law to regulatory agencies. As the “police force” of the markets, they use traditional tools of investigation and most recently, in response to technological changes in the operation of markets (Doering and Rampton 2010), have developed a number of complex monitoring algorithms to patrol the market for suspicious activity. These regulatory agencies, such as the SEC, have even been granted subpoena power—legal authority that compels the named individual or company to provide documents or provide a sworn testimony—yet their history has indicated that they are slow to gather evidence and file charges (Shapiro 1984). Seemingly, the regulators have been given nearly all the powers of the police, yet they have been reluctant until recently to prosecute (Snider 2009). When Bernie Madoff’s \$65 billion Ponzi scheme was discovered, it also became public that the SEC was alerted by multiple red flags and had received numerous tips regarding the scheme early on, yet had neglected to pursue an investigation (Zuckerman 2008; Bandler and Varchaver 2009; Pontell and Geis 2010). In the U.S., financial losses resulting from white-collar crime have been difficult to calculate precisely since no systematic data collection exists, however their costs have been estimated to be well into the hundreds of billions of dollars (Hartley 2008). Comparatively, the cost of conventional street crimes accounts for merely a fraction of the estimated cost of corporate crimes, yet there has been little push until recently to act responsively to corporate crimes (Shapiro 1984; Snider 1993). Government action has been swift when rates of robbery and homicide

appear to be on the rise, and threats to national security have been quickly addressed with laws that even affect citizens' right to personal privacy (the USA Patriot Act, for example). However with the increase of corporate crimes—or arguably, an increase in those crimes reported by the media—legislators appear to be dragging their feet, despite increased public attention. When they make the motions to pass new legislation on corporate crime, they face fierce lobbying from special interest groups, some of whom are also campaign contributors (this will be further examined in Chapter 4). Assuming that a piece of legislation does get passed through parliamentary proceedings, implementation involves careful consultation with the very subjects at whom the legislation is targeted, often asking regulators and investment firms to provide their input. (Snider 2008; Black 2010; Lichtblau 2010). The example of the Dodd-Frank Wall Street Reform and Consumer Protection Act will be discussed in Chapter 4. In contrast, street criminals have yet to be asked for their participation.

Internal controls: Self-regulation

Whether a corporation or a stock exchange (many stock exchanges are themselves privatized and publicly traded and thus operate in a similar structure as a publicly traded company) internal controls must also exist. Instead of uniformed officers keeping a vigilant eye for deviant activities of a corporation, external pressures lead these corporations and stock exchanges to adopt internal controls. Among stock exchanges, a large part of the internal control mechanism is its role as a self-regulatory organization (SRO). Although all companies that trade in the United States are subject to the overarching eye of the SEC, all stock exchanges have a duty to police themselves. There are layers of responsibility that require that organizations regulate themselves in addition to being under the regulation of another organization. The concept of “enforced self-

regulation” requires corporations to regulate themselves for compliance based on the rules that have been approved by government regulators (Braithwaite 1981-1982). Corporations (such as investment companies) use these rules to regulate the behaviour of their employees. In the context of stock market regulation, these corporations are listed, and their members trade, on stock exchanges that have the responsibility to police them. Policing is done on the exchanges through regulatory and surveillance divisions, all responsible for internal control. Stock exchanges are then required to report any violations to the federal regulator, the SEC, which is responsible for overseeing the stock exchanges as well as the listed corporations. This process will be further detailed in Chapter 3. At each level of responsibility, organizations use a number of tools to regulate; today many of these are technologically enabled. In addition to these internal control processes, there is a constant barrage of media updates on a corporation’s activities—some carefully prepared statements by public relations personnel and others as a result of investigative journalism—thanks to the prevalence of media and technology in business and society. The adverse publicity and stigma that could potentially result act as informal social controls to encourage the corporation to act responsibly (Simpson 2002).

When it comes to deterrence, traditional enforcement techniques such as punitive fines and sanctions have been less used in policing corporate crimes versus conventional crimes. In particular Meeks (2006-2007) identifies that there has been a move in white-collar crime toward the “identification and punishment of white-collar criminals through the regulation of the internal corporate structure, and the rehabilitation of misfeasor corporations” (87). The intention of emphasizing transparency is to address what Meeks (2006-2007) describes as the “one reason that white-collar crime exists” which is the “information gaps between investors and regulators on one side and corporations on the

other side” (88) Corporate disclosure is not new since it has been manifest in securities laws since the Great Depression, (the origin of many statutes on financial regulation) (Geisst 2004; SEC 2010d). Accountability and transparency have thus become one of the latest ‘regulators’ in the marketplace. One piece of legislation dealing with disclosure was the Sarbanes-Oxley Act of 2002 (SOX). Meeks (2006-2007) contends that “[b]y requiring companies to report their internal controls, SOX increases the likelihood that information about malfeasance is, when discovered, vetted to those most responsible for the company’s actions and well being” (91).

Often, internal controls such as the requirement for greater accountability and transparency have been revealed as inadequate and ineffective in either preventing or policing abuses. Combined with the efforts of the external controllers (the regulators and other law enforcement agencies), corporations and exchanges today are using modern technologies to do what cannot be easily done with the human eye: surveillance. With the technology that exists today (compared to what existed when the stock markets were initially founded), surveillance has the potential to oversee much of the activity that occurs in today’s markets. Yet, many of the tools of surveillance have been co-opted by the markets and by corporations themselves, and remain little used by regulators. In order to understand the potential of this technology in this field, it is important to explore the various literatures on surveillance.

Surveillance

This section examines a particular form of enforcement, one that has become ubiquitous in the prevention and enforcement of traditional crimes such as theft but appears, thus far, to be little used against high-level financial crime. This section will look first at the broader literatures on surveillance, particularly when applied to conventional

crimes, then look at its use to prevent, monitor and enforce laws regulating financial corporate crime. Lyon (2007) provides a general definition of surveillance that describes it as a “focused, systematic and routine attention to personal details for purposes of influence, management, protection or direction” (14). It is focused in that it directs its attention toward individuals, and it is systematic in its deliberate application of protocols and techniques. This section will begin by looking at the history of surveillance and its prevalence in our society—what has come to known as a “surveillance society” (Marx 1985). Next I will examine how surveillance is used in the detection and prevention of crime, specifically looking at areas of crime where it is most predominant. With this knowledge I can later assess the applicability of surveillance into areas of corporate crime, exploring what is currently used in Chapter 3, and in Chapter 4 the barriers that exist to further use of surveillance.

The history of surveillance

The origin of surveillance traces back to Jeremy Bentham in the 18th century, long before the days of video surveillance cameras. Bentham devised a structure for prisons called the Panopticon that served to maximize the surveillance ability of the guards. The design was of a circular building, with individual cells surrounding a central tower. Due to the shadows produced by the geographical configuration and the way the sunlight struck this tower, the occupants of the central tower (the guards) were not visible to the occupants of the cells (the inmates). This meant that the inmates could not see when they were being watched thus creating a structure of surveillance, the very first of its kind. Bentham’s design, as a prison structure, operated “to induce in the inmate a state of conscious and permanent visibility that assures the automatic functioning of power” (Foucault 1977: 201). Since the inmates could not tell when they were being watched,

they would be forced to internalize discipline and exercise self-control over their actions. Foucault (1977) later described panoptic surveillance as a form of “soul training”, an act which “seeks to transform individuals such that they shape their behaviour in prescribed directions” (27). He analyzed how this new model of power had been applied beyond prisons into hospitals, military and even schools to discipline the body. An important characteristic of Bentham’s panopticon was the shadowed invisibility of the central tower that provided a coercive force upon the prisoners. Foucault (1977) expresses that “power should be visible and unverifiable” (201), visible in that the prisoners could see the presence of the watch tower, yet unverifiable in that they could not see whether there was anybody in it, and therefore did not know if they were being watched. What he asserts is that this uncertainty produces a need by the subjects to comply with the norms of the institution, thereby paying careful attention to their own actions. This panoptic structure laid the groundwork for today’s concept of using surveillance as a tool for inducing “good” behaviour in those who are being watched.

Today, inmates are not the only ones under surveillance. Surveillance cameras, the most common form of panoptic surveillance, have been implemented in office buildings, in stores, and on the streets, monitoring the actions of everyday citizens, yet hiding from view those who are doing the watching. Because those who were being watched were unable to see or know when they were being observed, the theory stood that these subjects would alter their behaviour to socially acceptable actions. Haggerty and Ericson (2006) have conceptualized a “surveillant assemblage”—multiple objects whose functions come from uniting as one functional entity—to describe the omnipresence of surveillance. They describe the pervasiveness of surveillance into everyday life as having a “rhizomatic” effect, which Coleman and McCahill (2010) have illustrated as

“infinitesimal offshoots, interconnections, dispersed flows of data across border and between institutions” (24). Haggerty and Ericson (2006) describe its potential as “one that resides at the intersections of various media that can be connected for diverse purposes” (609). As such, it is pervasive in our everyday lives as it monitors us, be it in the workplace, through our purchasing patterns, and even in our everyday routines and movements. They argue that the proliferation of surveillance in the late 20th and early 21st centuries generated greater social visibility, and they claim that today, surveillance is directed at all social groups—not just aimed, as it had previously been, at those with less power.

However, as this thesis will later explain, not everyone is monitored in the same way or for the same purposes. Specifically some claim that surveillance plays an important role in establishing and reinforcing social inequalities and groups can therefore differentially exploit surveillance potentials (Lowry 2004; Monahan 2008; Coleman and McCahill 2010). In fact, it is often the more powerful actors that we find employing surveillance and generally directing it to keep the less powerful at a distance and to monitor their moves. Coleman et al. (2005) have described crime control strategies as gazing down the “social and political hierarchy at the expense of scrutinising upwards upon the harms generated through entrepreneurialisation itself” (2512). They recognized that surveillance was rarely questioned when employed by more powerful groups on less powerful groups. Lyon (2007) saw surveillance as widening the gap between the wealthy and the disadvantaged. The wealthy increasingly saw the other as a threat to its security, leading them to employ counter-measures against the poor and disadvantaged and thus, he argues, broadening the definition of crime (Lyon 2007: 49). These wealthy classes can obtain or utilize technologies of self-protection such as surveillance cameras and gated

“communities,” further excluding marginalized populations. Haggerty (2006) further suggests that privacy is becoming a marker of class privilege, whereby the more powerful groups attempt to “secure spaces of comparative privacy for themselves, while leaving the poor ever more exposed to scrutiny” (30). This applies equally to the upper echelons of corporations, particularly within the board rooms, wherein there never sits a surveillance camera to monitor either productivity or illegal acts. Furthermore Haggerty claims that rights to privacy are no longer a means for individuals to acquire personal space free from the state’s scrutiny; instead, privacy rights are “reconfigured” to serve corporate and state interests.

Surveillance in use

Surveillance as a tool has branched into various other fields (science, medicine, etc.) and given different applications. It does not only refer to cameras capturing videos but the term “surveillance” also refers to the practice of data-gathering of particular subjects. At customs and border stations, surveillance exists in the form of information gathering on those who pass through; it has monitored the on-site actions and movements of employees by employers; businesses gather information about their target markets through collecting information from stores; credit card companies maintain records of every purchase made and where it is made. This information is then used by the institutions involved to suit their own interests (Snider and Molnar 2010)

In the workplace, “theft of time” is reported by business media as costing hundreds of billions of dollars every year. This form of occupational crime—where the corporation is the victim of employees’ idling and use of company time and resources to conduct personal business (Hollinger and Clark 1983)—encourages the modern corporate employer to use technologies of surveillance to monitor the actions of their employees.

Snider (2001) argues that this theft of time was “invented and brokered as a social problem by academics in business schools, organizational psychology, sociology, and criminology” (106). At the different hierarchical levels of an organization, we find different tools of surveillance being used. Snider further contends that “inappropriate Internet use is primarily an issue for middle- and upper-level employees, where Internet access and freedom of movement on-line cannot be removed without compromising efficiency” (113). What is monitored at this level is the amount of time spent on non-work related sites, as well as which sites are visited. The lower-level employees, who do not have access to such freedom on the Internet, find every movement of their daily work routines under surveillance. At the same time, with company-wide use of active badges and key-card systems that can log and track where an employee is at any given moment, these employees find their breaks to be closely monitored and scrutinized by very precise technologies and time clocks. Clerks and customer service agents have their keystrokes and telephone calls recorded and monitored for speed and efficiency. Yet employees do not know when they are being monitored until they are faced with the repercussions of their “theft of time.” However, one important hierarchical level appears to be missing from the gaze of surveillance. Those who sit in the posh offices on the executive floors, the highly positioned upper level executives and directors, work relatively free of company monitoring of their emails and Internet activity. The reason for this will be further explored in Chapter 4.

In the context of traditional criminal offences such as homicide, theft and robbery, and organized crime, surveillance has been employed predominantly in two instances: the detection of crimes, and the monitoring of offenders. Wiretaps as a form of surveillance have been employed by law enforcement since the early 1890s, when police first began

tapping the phone calls of those involved in organized crime. However, this eventually became a tool that was abused by government actors, as they eventually usurped this technology to further their own agendas by supporting corruption and harassing opponents (Freidwald 2004). Consequently, the federal government was compelled to implement legislation governing the use of wiretaps. In the United States, this was Title III of the Omnibus Crime Control and Safe Streets Act, also known as the Wiretap Act of 1968; Canada's the wiretap legislation fell under Bill C-176, the Protection of Privacy Act (Manning 1978). This technology has been embraced by politicians as a tool to deter crime and in some countries (such as the UK) there are cameras placed on virtually every street corner¹¹. In its other uses, after the offender has been sentenced or released, surveillance in the form of electronic monitoring is used. Ankle bracelets equipped with GPS track the travels of the offender, as well as monitoring curfews, creating restrictions on personal liberty that did not previously exist. Satellite tracking was introduced as a form of electronic monitoring to ensure that offenders attended the required work or rehabilitation programs (Nellis 2005).

Although less powerful groups have most often been the target of the surveillant gaze, the powerful have not been completely excused. Due to the advancement of technology and the popularity of social media, a phenomenon called a *synopticon* has emerged. Where a panopticon serves as a tool for a few people to watch many, a synopticon allows many people to watch the few. It exists in the form of social media and various media forms that have thrust celebrities, politicians, and those wealthy and

¹¹ McCahill and Norris (2003) estimate 4.2 million cameras in the UK, approximately one for every 14 people. However, through a meta-analysis of the studies conducted on the effectiveness of surveillance cameras on the street, Welsh and Farrington (2009) found that increased street lighting produced a more significant reduction of crime than CCTV.

powerful enough to garner attention into the spotlight, allowing their every move to be documented and scrutinized. As early as the 1970s, long before social media, investigative journalism began scrutinizing corporations and today, those in the spotlight can be confronted by their activities and their language, held accountable for their actions in the eyes of an entire nation and, thanks to the Internet, the world. However, it can be argued that the synopticon still exists on a very cursory level, lacking the omnipresence and even invasiveness that characterizes panoptic surveillance. Indeed, the public relations machines work to create a first-rate public image of corporations. However, the business decisions of powerful actors on Wall Street are watched by many through the media and through the chain reactions that business decisions set off. Still, the individual actions taken in the course of business—in which corporate takeovers are planned, accounting statements are manipulated and questionable financial instruments are created—remain unwatched. Furthermore, these individual actions, hidden from the eyes of the public (the reason cited is often to maintain a competitive advantage), accumulate into massive scandals causing reverberations into the economy leading people to lose their pensions, their savings and their homes. On the other hand, when surveillance has failed to work on the disadvantaged, rarely are so many people affected with such disastrous life-altering consequences. It is for this reason that it is important to examine surveillance, or lack thereof, in the financial community.

Conclusion

As a tool of enforcement, surveillance has often been employed by law enforcement officials to target traditional forms of crime. The area that surveillance has been overlooked as a tool, until recently, is in high level and often complex financial crimes. In order to understand why this is, this literature review has examined the

evolution of white-collar crimes, the changing viewpoints on this wide category of crime, and then explored the history and current uses of surveillance. In the next chapter, I will first discuss the dominant tools of enforcement used by the major law enforcement agencies that investigate white-collar crime in the United States. Second, by looking at three examples of how surveillance has actually been used to address financial crimes, I will examine how effective, or ineffective, surveillance has been as an enforcement tool in the area of stock market crime.

Chapter 3

Dominant Tools of Surveillance Used in Corporate Crimes

Introduction

This chapter takes a closer look at the dominant tools of enforcement used to address corporate crime. When corporate crime occurs, it violates not only the standards and rules governing a particular industry, but often administrative, civil and/or criminal law as well. Enforcement can be taken by various divisions at the regional or federal level, all possessing different powers of authority. In the United States, which will be the country at the focus of this discussion, the Securities and Exchange Commission (SEC) is the most powerful regulatory body governing the marketplace. Its reach extends beyond its national borders into the international marketplace as well, where it stands as a dominant regulator and a model for regulatory changes abroad (Pan 2003).

The reach of the SEC extends all the way into Europe even as the European Union attempts to consolidate its markets. As an influential regulator in the U.S. the SEC maintains a strong presence in intergovernmental organizations such as the International Organization of Securities Commissions (IOSCO), laying heavy influence on the development and modification of standards and practices. At the same time, American securities firms remain dominant in European markets, urging European exchanges and regulators to recognize or adopt U.S.-style disclosure practices such as U.S. GAAP¹². Acceptance of U.S. disclosure standards is a way to attract listings from U.S. companies, and target new companies about to make initial public offerings in Europe (Pan 2003). It

¹² More recently in 2005, International Financial Reporting Standards (IFRS) have been implemented in the European Union, and in 2008 the SEC has begun shifting to recognition of IFRS as well as U.S. GAAP.

also allows them to have flexibility to work with U.S. companies in the future. However, the foremost reason why the SEC has such influence in Europe is that European markets lack a sufficiently powerful body with jurisdiction over all countries in the EU (Pan 2003). Legislation intended to govern within the United States often has international impact, not only through multinational corporations that are based in the U.S. and therefore subjected to its governance locally and abroad, but also in the ability of U.S. federal agencies to legally reach beyond its national borders (such as what the SEC has been able to achieve) (Pan 2003). Additionally, as the 2008 stock market meltdown indicates, international markets are directly affected by economy-altering decisions and actions taken in the United States.

This chapter will begin with a brief discussion of who has enforcement powers within the United States, examining the different levels at which enforcement can be taken on a suspected offence. Not only do the different levels of authority handle enforcement differently, but they also are limited by the sanctions that they are permitted to implement. Next I will focus on the enforcement powers of the Securities and Exchange Commission as a federal regulator, its structure, and the tools and sanctions which it uses to address infractions in the marketplace. Though in the recent years it has come under criticism and scrutiny for failing to prevent several major financial frauds, the SEC remains the agency primarily responsible for laying charges against market deviants in the United States (IOSCO 2010). Following that, I will look at how the Federal Bureau of Investigation, which handles criminal law violations, addresses corporate crime. Here there will be a discussion of the role of this law enforcement agency, enforcement tools used—at least those which are publicly disclosed—and the sanctions which can be enforced. As I provide the history and description of these two law enforcement agencies,

I will then demonstrate in the remainder of the chapter how surveillance comes into play (or has not come into play) as an enforcement tool.

Who has enforcement powers?

When a violation is suspected, it can be addressed at various levels by different entities and agencies. At the broadest level, violations can be addressed by administrative (regulatory), civil, and criminal laws. In the United States, at the federal level, these laws are enforced by two dominant agencies: the Securities and Exchange Commission (SEC) and the Federal Bureau of Investigation's (FBI) White Collar Crimes Unit. At a more local level, states are responsible for passing and enforcing legislation, often called "blue sky laws," which give authority to state securities regulators. These laws outline standards for those conducting business in the state. The SEC also has offices in many states, where they enforce federal securities laws, and these offices can refer or escalate more complex cases to the federal agency. At the industry level, speaking specifically of the securities industry, corporations are also regulated by what is called "soft law," through non-governmental self-regulatory organizations (SROs), which have authority over their registered members. Professional associations such as broker-dealer associations also operate as SROs as they have the authority to create and enforce industry regulations and standards for their members. For example, the Financial Industry Regulatory Authority (FINRA) is an SRO that resulted from a merger of the former regulator, the National Association of Securities Dealers (NASD), and the New York Stock Exchange (NYSE). Among the thousands of brokerage firms and registered securities representatives that it regulates, FINRA also performs market regulation of major United States stock markets such as the NYSE and NASDAQ. Within its duty as an independent regulator is the task to ensure that these markets comply with federal securities laws, as well as educating the

investing public and acting as a dispute resolution forum. FINRA also has the ability to refer more serious, or potentially criminal, cases to the SEC and the FBI for investigation.

Due to the fact that there is constant overlap of administrative, civil and criminal laws governing various violations, investigations often cross jurisdictional boundaries. The SEC uses administrative, civil, and quasi-criminal law as a tool to regulate the bodies under its jurisdiction, whereas the FBI, working on behalf of the Justice Department, uses criminal law (McCaffrey and Hart 1998). However the two agencies often find themselves cooperating in investigations. This chapter will focus on these two agencies, the SEC and the FBI, exploring the enforcement tools that each can, and does, employ to regulate and investigate under their respective areas of law.

The Securities and Exchange Commission

In 1933, the first of two important securities laws was passed in the United States. The Securities Act of 1933 arose from The Great Crash of 1929, the crash of the stock market which infamously led to the Great Depression that effectively destroyed public confidence in the markets (Geisst 2004; SEC 2010d). Following the Securities Act of 1933 came the Securities Exchange Act of 1934, which created the Securities and Exchange Commission (SEC), a federal regulator “designed to restore investor confidence in our capital markets by providing investors and the markets with more reliable information and clear rules of honest dealing” (SEC 2010d). The Securities and Exchange Commission would be a new federal regulatory agency in the United States with “broad authority over all aspects of the securities industry” (SEC 2010d). Before the SEC and the Securities Act of 1933—the first piece of national securities legislation ever passed by Congress (Geisst 2004)—securities were only governed by what were called “blue-sky laws.” These blue-sky laws, passed during World War I in a small number of

western states, required investment bankers to register securities with the appropriate state authorities in order to sell them to investors in the state (Geisst 2004; McCaffrey and Hart 1998). However, the Great Crash proved that the blue-sky laws “contained so many loopholes that unscrupulous brokers and investment bankers could easily circumvent” (Geisst 2004: 228). These state laws, though uncommon in the majority of the United States at the time, were an important precedent for the securities reforms to come.

Since the creation of the SEC in 1934, and the recognition by the federal government of a need to regulate securities, a number of regulatory bodies have been established. Each watches over a different aspect of the financial markets from commodity futures and options (Commodities Futures Trading Commission) to credit unions (National Credit Union Administration) to national banks (Office of the Comptroller of Currency). The SEC has emerged as the most powerful of these regulatory agencies, dominating with both financial and employee resources (IOSCO 2010). This agency is governed by five laws: the Securities Act of 1933, the Securities Exchange Act of 1934 (from which it was created), the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 (McCaffrey 1998; SEC 2010d). These five laws established between them the official legal principles that “companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing” and that the “people who sell and trade securities—brokers, dealers, and exchanges—must treat investors fairly and honestly, putting investors’ interests first” (SEC 2010d). In the past decade, two more pieces of legislation have had significant impact on the power and authority of the SEC: the Sarbanes-Oxley Act of 2002 (SOX) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Originally granted authority by the Securities Exchange Act of 1934, the SEC is an independent federal regulator that has the power to “register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations” (SEC 2010d). All publicly traded companies—and their brokers, dealers, and investment advisors—fall under the authority of the SEC. At the top of the SEC hierarchy sits “the Commission” which is comprised of five commissioners and a chairman, all of whom were appointed by the President of the United States and confirmed by the Senate. Within the SEC, five divisions oversee the markets and the actions taken by corporations. These five divisions are organized as such: Corporate Finance; Enforcement; Risk, Strategy and Financial Innovation; Investment Management; and Trading and Markets. Despite its five divisions, the SEC is, above all, a law enforcement agency (SEC 2010d). With a total budget of \$970 million in 2009¹³, the SEC has devoted nearly 55 percent of its funding (approximately \$323 million) toward enforcement and examination programs (SEC 2009a). Enforcement was originally spread across the various operating divisions in the SEC, and it was 1972 when they were finally consolidated into the Division of Enforcement. At the enforcement level, the SEC has the authority to utilize the tools granted to them through the rulings of Congress and the aforementioned federal statutes, as well as the ability to issue new rules and amend existing ones to govern their members. Cases brought to the attention of the SEC are assigned into one of eight categories of enforcement: financial disclosure, investment advisers and investment companies, broker-dealers, securities offerings, insider trading,

¹³ Figures from the SEC’s 2009 Performance and Accountability Report are used in order to facilitate comparison with the FBI’s 2009 Financial Crimes Report, which is the most recent available source of white-collar crime statistics from the FBI at the time this thesis was written.

market manipulation, delinquent filings, and other. Financial disclosure made up the largest category at 22 percent of cases in 2009.

According to the SEC Enforcement Manual, the enforcement process begins when the SEC obtains evidence of possible violations of securities laws from various sources including market surveillance activities, investor tips and complaints, the self-regulatory organizations and other securities industry sources, and media reports. They also receive referrals of cases of potential violations from any of the other divisions and offices of the SEC, often at the regional level. Once the investigation is initiated, the enforcement division develops its case through informal inquiry, interviewing witnesses, examining brokerage records, reviewing trading data, and other methods. Through the informal development of facts, possible violations may be discovered to be merely unusual fluctuations in the market, and no wrongdoings may be found, at which point the case may be dropped. In pursuing a case, though, inquiries are directed at the target individual or organization and, depending upon the level of cooperation received, the following may occur: the investigation may be dropped if no wrongdoings are found or not enough evidence can be obtained; a formal order may be sought; or a settlement may be arranged. If a formal order is initiated, “members of the staff designated by the Formal Order to act as officers of the Commission for the purposes of the investigation may administer oaths and compel testimony and the production of evidence, among other things” (SEC 2011: 25). The investigative staff informs the target of imminent charges that may result, and during this stage, the target is given an opportunity to provide a “factual and legal presentation to the Commission setting forth the position of the party being investigated” (Ruder 1990-1: 608). In a formal order of investigation, the Division possesses the power to subpoena witnesses to testify, produce books, records and other relevant documents.

Following the investigation, enforcement staff present their research to the Commission for review, and Commission members decide whether the staff may file a case in federal court or bring an action before an administrative law judge within the SEC¹⁴ Frequently, if the target is cooperative, the two parties reach a settlement here on the action to be taken, however in the event that a settlement cannot be reached the Commission will bring forth an action.

The Commission has the power to conduct investigations, discipline persons subject to its jurisdiction, initiate injunctive actions, and refer criminal cases to the Justice Department (Ruder 1990-1). In these cases, the level of cooperation of the subject may impact the enforcement actions that are taken or not taken. “The Commission may also, on some occasions, refer the matter to, or grant requests for access to its files made by, domestic and foreign governmental authorities or foreign securities authorities, SROs such as stock exchanges or the [Financial Industry Regulatory Authority, Inc.], and other persons or entities” (SEC 2011: 115-116). In the civil suits, the SEC may seek injunctions (orders that prohibit future violations), monetary penalties, and the disgorgement of illegal profits (repayment of the proceeds from the wrongdoing) as sanctions (Ruder 1990-1). Furthermore, the SEC may revoke or suspend registration and membership of its regulated entities, and bar or suspend individuals from employment as corporate officers or directors. At the level of the individual, civil penalties and disgorgement may also be imposed [See Figure 1].

¹⁴ The administrative law judge is independent of the Securities and Exchange Commission, but acts within the Commission, and presides over administrative proceedings. After hearing the evidence of an offence presented by the Commission staff, the judge may impose administrative sanctions such as cease and desist orders, suspension or revocation of broker-dealer and investment advisor registrations, censures, bars from association with the securities industry, civil monetary penalties, and disgorgement.

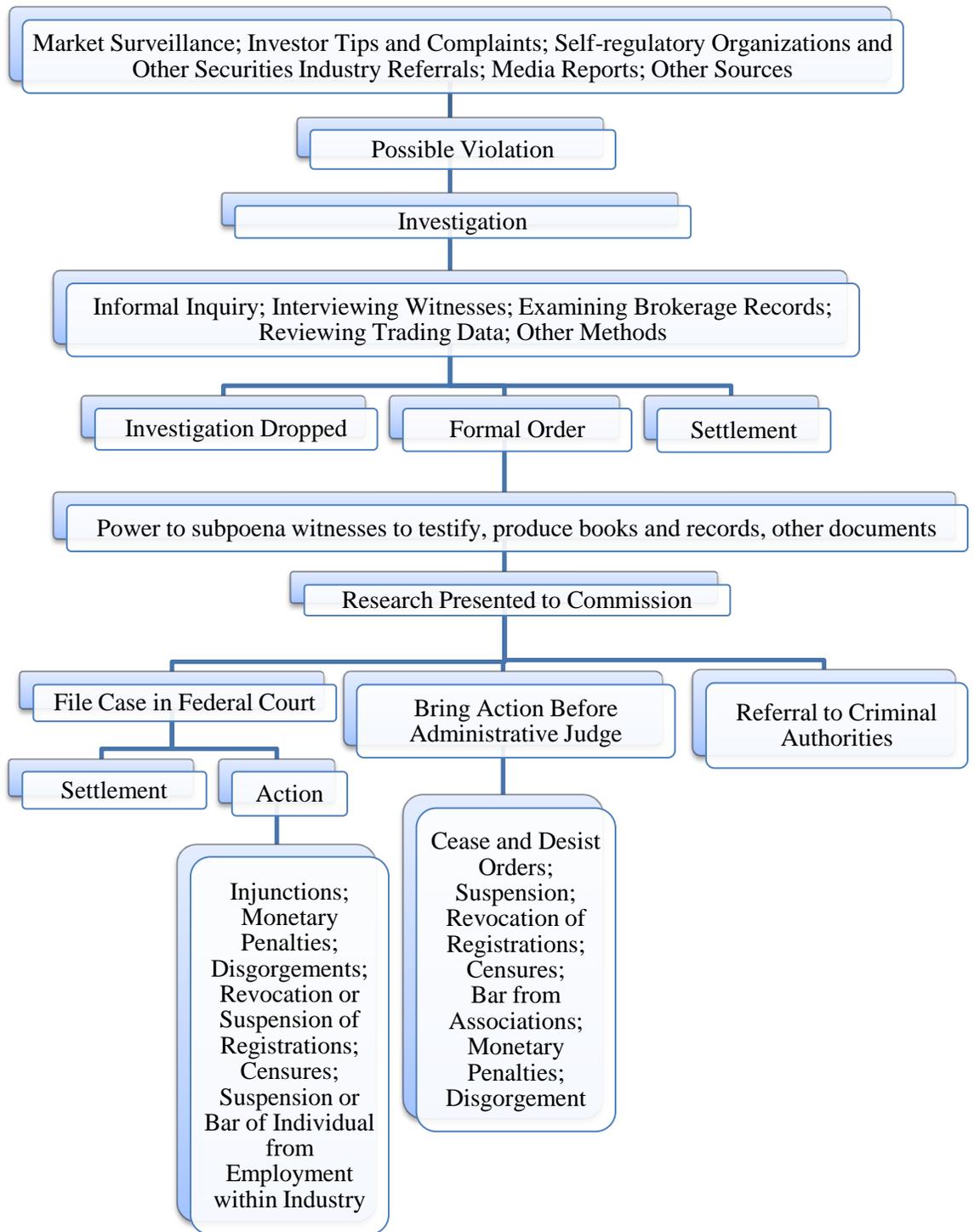


Figure 1: The SEC Enforcement Process

The SEC did not always have such broad enforcement powers. Prior to 1990 it lacked the authority to seek monetary penalties. In fact, before 1990, the SEC could only obtain monetary penalties in cases of insider trading, an authority that it first obtained in 1983. Furthermore, cease and desist orders, along with the authority to bar certain officers and directors, were also not within the authority of the earlier SEC. The latter authority to directly suspend or bar individuals from the securities industry only dates back to 1975 (Katz 2010). Alternatively, Branson's (2010) argument is that the SEC was once powerful, but over time has seen its authority decrease:

The principal problem is that the SEC has now become the last fire truck to arrive at the scene of the fire, when not too long ago it was leading the charge. Many times the SEC fire truck arrives at the fire not at all. Other times, it arrives, but late and behind the wheel of a dinky little fire truck, ill-equipped to extinguish the fire; limping along in this fashion, the Commission is disrespected further and even ignored by Wall Street, not to mention federal judges. (Branson 2010: 546)

Under the Sarbanes-Oxley Act of 2002 (SOX)—passed after the surge of corporate bankruptcies that occurred at the end of 2001—the SEC was granted enhanced enforcement tools, among which was authority over professionals who appear and practice before the Commission, the ability to temporarily freeze certain extraordinary payments made to securities law violators and authority in administrative proceedings to prohibit persons from serving as officers or directors (SEC 2003). Although this piece of legislation would eventually fail to prevent the next financial crisis, Soederberg (2008) asserts that SOX was portrayed by the Bush administration “not only as a regulatory mechanism that aims to transform the way in which publicly traded companies control their internal processes, but also as the single most dramatic event in the world of commerce since the creation of the New Deal” (658). To compensate for many of the shortcomings of SOX which became apparent after the financial crisis of 2008, the

Obama administration sought to rectify many of the ambiguities that had not been addressed when the Act had been rushed through Congress (this will be explored in Chapter 4). The most recent Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 expands SEC enforcement powers to include: greater rewards for and protection of whistleblowers; extending the SEC’s ability to impose administrative fines on all persons not merely brokers and investment advisors and associated persons (including those not directly regulated by the SEC through their profession); broadening the SEC’s extraterritorial jurisdiction to alleged violations that occurred overseas (Dodd-Frank Act 2010).

In 2009, the Enforcement Division—charged with the task of overseeing the eight categories of enforcement previously mentioned—was reorganized into specialized investigative groups dedicated to five different areas. Units of Asset Management Unit, Market Abuse Unit (which will be explored in later in this chapter), Structured and New Products Unit; Foreign Corrupt Practices Unit, and Municipal Securities and Public Pension Unit were set up. According to the 2010 speech made by Robert S. Khuzami, the Enforcement Division’s Director, their staff would “receive training customized to reflect market developments and particular investigative challenges in those subject areas” (SEC 2009a: 18). Also in the 2009 fiscal year, the SEC moved more investigators and attorneys to the front lines, eliminating a layer of management and effectively removing any procedural barriers to the staff’s investigative and litigation practices (SEC 2009a)). This reportedly led to 6 percent more cases being opened, making for a total of 944 cases commenced in 2009¹⁵. In that same year, the SEC reported closure of 716 investigations¹⁶

¹⁵ Note that cases reported to be open in a fiscal year do not necessarily indicate that it will be closed in that same year.

(SEC 2009a). Subsequently, the SEC reported that it successfully resolved 92 percent of cases; a successful resolution being defined as one that results in a “favourable outcome for the SEC, including through litigation, a settlement, or the issuance of a default judgment” (SEC 2009a). Further in its efforts to reshape the Enforcement Division, the SEC recently announced that it was making available three new tools for incentivizing cooperative insiders: Cooperation Agreements (in which the individual or company can receive credit for “substantial” cooperation in an investigation or enforcement action); Deferred Prosecution Agreements (in which enforcement actions are foregone against a cooperating individual or company if the co-operator agrees to fully and truthfully comply with certain reforms, controls and other undertakings such as paying fines); and Non-prosecution Agreements (in which under very “limited and appropriate” circumstances, the Commission agrees not to pursue an enforcement action against a co-operator (SEC 2010e).

When regulatory offences also violate criminal law, the SEC, which lacks the authority to prosecute criminal cases, refers cases to criminal law enforcement agencies such as the FBI. Criminal investigations may be (and often are) conducted at the same time as the SEC’s civil investigations. Confidentiality remains paramount, despite the inter-agency cooperation. Therefore investigations that originate from the SEC require the FBI to make its requests “through the proper channels” in order to obtain privileged information contained in corporate documents filed with the SEC; they cannot be merely handed over (SEC 2011). This courtesy can be seen in international regulatory domains as well, as Canadian regulators and police also often work in conjunction with each other;

¹⁶ Closure of a case does not necessarily indicate enforcement action; it could merely denote that there was insufficient evidence to proceed with the investigation.

however information only freely flows from the police to regulators, but not from regulators to police. This is often seen by critics as bureaucracy that impedes criminal investigations into white-collar crime, particularly within Canada (Williams 2009). Nonetheless, the FBI takes a similar approach to its investigations into white-collar crime.

The Federal Bureau of Investigation

In 1908 the Federal Bureau of Investigation (FBI; or the Bureau) was founded by Attorney General Charles Bonaparte, during the presidency of Theodore Roosevelt, to act as a federal law enforcement agency. However, at the time that it was established there were few crimes officially designated as “federal crimes.” Thus it focused on investigating violations of laws involving national banking, bankruptcy, naturalization, antitrust, and land fraud (FBI 2010a). Over the years, it gained prominence through investigations of the “lawless,” the criminals of the “gangster era”; saw its jurisdiction expanded through the passing of several federal laws that granted the FBI exclusive jurisdiction; and received forensic assistance through the development of its own research laboratory. It was not until the 1970s that the FBI finally shifted focus to white-collar crimes. This arose from the declining public confidence levels due to the Vietnam War and the Watergate scandal of the Nixon administration (Poveda 1999). Before the 1970s, the FBI had investigated forms of crime such as bank fraud and embezzlement as simply bank fraud and embezzlement; they were not re-classified as white-collar offences until 1974 (Webster 1980). Subsequently, in 1980, the white-collar crime investigative priorities within the FBI were ranked as follows:

- 1) Corruption of officials in government, labour, or business; bank closings; bank embezzlements involving losses in excess of \$100,000; and frauds in federal programs.

- 2) International frauds or national fraud-by-wire schemes involving multiple perpetrators or victims; planned bankruptcies; other major bank fraud and embezzlements; and investigations of copyright violations.
- 3) All other white-collar crimes such as those smaller scale matters involving patents, copyrights, fraud against the government, and fraud-by-wire. (Webster 1980: 279)

The FBI defined (and still defines) white-collar crime as those illegal acts which are “characterized by deceit, concealment, or violation of trust and are not dependent upon the application or threat of physical force or violence. Such acts are committed by individuals and organizations to obtain personal or business advantage.” (FBI 2009a).

Due to the re-classification of many new offences into this category, the Bureau began to reallocate its investigative resources into this program. The priority of white-collar crime investigations, along with the budget dedicated to the area, increased steadily until the 1980s when the focus shifted from white-collar crime to the “war on drugs” and drug trafficking (Simon and Swart 1984; Poveda 1999). The white-collar crime unit has not since been able to regain the momentum it had in the 1970s, particularly not since the events of 9/11. After September 11, 2001, anti-terrorism became a priority for law enforcement and consequently budget increase requests from the White-Collar Crime Unit were repeatedly denied in favour of funding for anti-terrorism (Lichtblau, Johnston and Nixon 2008). In that re-organization, the FBI transferred approximately five hundred White-Collar Crime Unit specialists into the area of national security, and since then, the specialists and resources for that unit have yet to be replenished (Quick 2010).

The process of investigating potential violations may cross the ambiguous boundaries between administrative, civil and criminal law, therefore the SEC and the FBI often cooperate in investigations. The FBI is home to the premier law enforcement unit that addresses the criminal law violations of corporate crime: the White-Collar Crimes

Unit. When corporate offences violate criminal law, FBI agents often find themselves working with investigators from the Securities and Exchange Commission, the Internal Revenue Service, the U.S. Postal Inspection Service, the Commodity Futures Trading Commission, the Treasury's Financial Crimes Enforcement Network, and Special Inspector General for the Troubled Asset Relief Program, among others, in its pursuit of white-collar crime (FBI 2009a).

In the White-Collar Crime Unit, corporate fraud, securities and commodities fraud, health care fraud, financial institution fraud, mortgage fraud, insurance fraud, mass marketing fraud, and money laundering are identified as “priority crime problem areas of the Financial Crimes Section (FCS) of the FBI” (FBI 2009a). The Financial Crimes Section was broken down into five units—Asset Forfeiture/Money Laundering Unit, the Economic Crimes Unit, the Health Care Fraud Unit, the Forensic Accountant Unit, and the National Mortgage Fraud Team—notable among which is the Economic Crimes Unit (ECU), responsible for “significant frauds targeting against individuals, businesses, and industries” (FBI 2009a). The ECU investigates, among many, corporate fraud and securities and commodities fraud. In 2009, the FCR reported that “while the number of cases involving the falsification of financial information remained relatively stable, the FBI has observed a spike in the number of corporate fraud cases involving subprime lending institutions, brokerage houses, home-building firms, hedge funds and financial institutions, as a result of the financial crisis partly caused by the collapse of the subprime mortgage market in the fall of 2007.” Thus corporate frauds remain a high priority for the FBI. By the end of 2009, “the FBI was in pursuit of 592 corporate fraud cases throughout the United States, several of which involved losses to public investors that individually exceeded \$1 billion.” (FBI 2009a)

FBI sources declare that the agency works in cooperation with other investigative agencies, as well as numerous organizations in the private industry to increase public awareness about combating corporate fraud (such as the Public Company Accounting Oversight Board, and the American Institute of Certified Public Accountants). “These organizations have been able to provide referrals for expert witnesses and other technical assistance regarding accounting and securities issues” (FBI 2009a). The FBI also reports cooperation with the Financial Crimes Enforcement Network (who attempt to protect the U.S. and International financial systems from abuse) and Dun and Bradstreet (who provide significant background information on subject individuals and/or subject companies) to further their investigative efforts (FBI 2009a; FinCEN 2010; Dun and Bradstreet 2010). In the 2009 fiscal year, the Financial Crimes Report recounts cases pursued by the FBI in the area of corporate fraud resulting in 153 indictments and 156 convictions of corporate criminals, while numerous cases (approximately 592 cases) are still being investigated or pending plea agreements and trials. During the 2009 year, the FBI secured \$6.1 billion in restitution orders and \$5.4 million in fines from corporate criminals and organizations for corporate fraud. In the following 2010 fiscal year, the budget for the entire Bureau was approximately \$7.9 billion, including \$618 million in program increases to enhance counterterrorism, computer intrusions, surveillance, weapons of mass destruction, white-collar crime, and training programs. The actual share of the budget that is dedicated to combating white-collar crime remains unknown.

Over the last five years, the FBI noted the evolution of frauds, particularly in the area of securities and commodities fraud. New schemes such as manipulation within the securities markets through “cyber intrusion,” along with an apparent increase in Ponzi schemes due to market deterioration, have prompted an increase in the number of

securities and commodities fraud cases investigated by what the Bureau calculates to be nearly 33 percent of the total white-collar crime cases that it investigates. The losses associated with these schemes have, by their accounts, increased to billions of dollars. By the end of 2009, the FBI reported that it was investigating 1,510 cases of securities and commodities fraud and had already recorded 412 indictments and 306 convictions in this area. In addition to the charges laid against individuals involved, the FBI reports that it has obtained \$8.1 billion in restitution orders; \$63.4 million in recoveries; \$12.8 million in fines; and \$126 million in seizures. The official statistics gathered and reported by the FBI are publicly available in the Uniform Crime Report (UCR)¹⁷.

Enforcement tools in current use

As noted above, the SEC and FBI both manage different forms of law: the SEC pursues offences under civil and administrative law, the FBI under criminal law. Between them, the two agencies have thousands of staff and agents at their disposal for combating white-collar crime. The SEC receives information about violations through market surveillance tools, investor tips and complaints, media reports, and referrals from other agencies. It investigates potential violations through conducting interviews and scrutinizing documents. To enforce the civil and administrative laws, it can take a target to court or order the target to appear before an administrative judge, issue sanctions in the form of cease and desist orders, suspension or revocation of registrations, civil monetary penalties, and disgorgement of ill-gotten profits. As it stands, the tools available to the SEC to detect violations or enforce laws have little to do with surveillance (an example of

¹⁷ The UCR has faced criticisms over the years over the validity of the UCR firstly as a public document, and secondly for the impact that its figures have on creating and amending crime policies. Citing what is known as the crime funnel, critics argue that the official statistics represented by the UCR denote merely a small fraction of the actual amount of crime committed, including unknown and unrecorded crime called the “dark figure of crime” (Robison 1966).

an exception will be discussed later on). Furthermore the restitutions it imposes also rarely involve technological monitoring of the actors as we generally understand surveillance to do. As will be discussed later on, the same could be said for the FBI until very recently, although they utilize modern technologies of surveillance in other divisions. Instead, they tended to employ enforcement tools similar to those used at the SEC, mainly focusing on the analysis of company documents, and occasionally employing undercover operations.

Before the cries of the trading pits were exchanged for online trading mechanisms which can make transactions in fractions of a second, pit traders served as surveillance mechanisms in and amongst themselves. Zaloom (2006) observed that “The pit is an exchange technology intentionally designed as an arena where a trader can see or be seen by every other trader” (98). Advocates of the former open outcry system of trading argued that “the social environment of the pit, where traders know and watch each other, is a more effective forum for identifying illicit market activity” (54). They contend that this layout in fact offers greater transparency than the electronic market where criminals can be hidden behind a screen. However, the outcry trading pits were eventually replaced by computer interfaces and the frenzied exchanges of floor traders were replaced by electronic readouts on monitors. Eventually surveillance was forced to evolve as well. No longer were traders able to watch each other; now stock exchanges and their regulators rely on market surveillance systems to detect market manipulation.

Shapiro (1984) identifies that the SEC has two strategies of enforcement: reactive and proactive. The reactive strategies mobilize SEC investigators when information is provided by agency outsiders such as described in the various sources above. In contrast, the proactive strategies are labelled “surveillance” by Shapiro in that the investigators

actively monitor public events and communications that are accessible to the general and interested public. Shapiro (1984) describes the proactive strategy of surveillance conducted by the investigators as that which attempts to “observe the public behaviour of their varied participants and audiences and monitor the public byproducts of illicit promotions and transactions in the hope that they might suggest illegal activity” (57). In the earlier days before securities trading became entirely electronic, investment schemes were advertised in the media through newspapers, business periodicals, trade journals or other specialized publications, radio, and television. Surveillance was present in its least technical sense in one instance that Shapiro describes, where an SEC enforcer “watching the televised proceedings probing illicit corporate campaign contributions began to wonder about the source of these funds, the mechanisms for creating slush funds, and the disclosure of these activities to corporate stockholders” (59).

Current securities regulators act proactively by using electronic market surveillance systems in the form of complex computer algorithms and computerized assessment tools (Williams 2009). Within financial markets, market surveillance systems, generally operated by the entities which the SEC regulates, are used to detect violations of securities laws; however they are more commonly used in detection than in sanctioning violators (Williams 2009). Generally, market surveillance systems come in the form of software programs, designed to follow the patterns of the market. “Where patterns exceed or vary from some specified set of parameters, the ‘deviant case’ is isolated and further investigation is pursued” (Shapiro 1984: 59). That deviations or anomalies are ‘flagged’ by these programs for investigation staff to follow-up on, reveals that standards set by the regulatory agencies themselves determine the ‘threshold’ for the amount of financial crime that is permitted. This is one of the criticisms of the current market surveillance

systems that will be discussed in later on. With respect to the traditional forms of surveillance that are commonly evoked as tools of enforcement, such as surveillance cameras and eavesdropping devices, corporate crime has either lagged behind or has decisively avoided using these tools. Moreover, as a tool that is often used in “conventional crimes,” surveillance—cameras or otherwise—remains infrequently mentioned in the literature of law enforcement on corporate crime (Coleman and McCahill 2010). The following examples will demonstrate this and I will explore the implications further in Chapter 4.

Surveillance in corporate crime: Three examples

The following discusses three examples of surveillance use, noteworthy because they are exceptions to the general rule that electronic surveillance is seldom used to address corporate crime. Surveillance, as described in the Literature Review, is all-encompassing. Notably, it has been used by those in power to monitor those who are less privileged and those who work on the lower end of the organizational hierarchy. In its limited uses in financial markets, surveillance is utilized to monitor markets, more specifically, the actions of traders, but only to track their trades through the computer and to monitor phone calls and emails. In the first example, audio and video surveillance—tools generally associated with the term surveillance—is temporarily employed as a sanction against violations committed by traders. In the second example, I examine the SEC’s new Market Abuse Unit that uses technological surveillance in the form of high-speed algorithms and background checks in order to detect market abuse. Finally, with the latest crackdown on the crimes of Wall Street, I will examine the newest push for wiretapping surveillance on traders. This is demonstrated in the ongoing case against a

major American hedge fund group's executives, and the implications that it will have on future surveillance use.

The New York Stock Exchange Pilot Program

In 2006, the SEC made its first brief venture into employing surveillance upon its regulated entities. As a self-regulatory organization, the NYSE is required under the Securities Exchange Act of 1934 to comply and enforce rules and regulations governing member behaviour under the Exchange Act. It was discovered by regulators that from 1999 through to 2003, various NYSE specialists engaged in unlawful interpositioning¹⁸ and trading ahead¹⁹ of customer orders resulting in more than \$158 million of customer harm. Investigation of this matter was originally the duty of the NYSE's Market Surveillance division that is charged with probing abuses relating to insider trading, market manipulation, trading irregularities, and violation of NYSE rules (Ellis, Fairchild, Fletcher 2009).

The SEC deemed the regulatory response of the NYSE to be deficient for the following reasons: the surveillance system to detect this unlawful behaviour was inadequate; the NYSE surveillance division failed to conduct adequate investigations into the violations; and the NYSE failed to properly discipline the specialists involved in this behaviour (SEC 2005a). In a confidential inspection report exposed by the *Wall Street Journal* about these violations, the SEC was "concerned that the NYSE's disciplinary program is viewed by specialists and specialist firms as a minor cost of doing business, and that it does not adequately discipline or deter violative conduct" (Solomon and Craig

¹⁸ "Interpositioning" is the "unlawful practice of adding an extra broker/dealer as a principal on a trade, even if no service is provided. Typically, interpositioning is done as part of a mutual benefit strategy, sending commissions to the broker/dealer in exchange for referrals or other cash profit" (Investopedia.com 2010a).

¹⁹ "Trading ahead" is trade transacted from a specialist's account even though there is a public order that offsets the trade" (Investopedia.com 2010b).

2003). The SEC found that the NYSE failed to detect the violations in part due to the stock exchange's reliance on an automated surveillance system that had parameters and procedures that were too broad. As a result, the NYSE was ordered to implement a pilot program for an audio and video surveillance system to track trading floor activity (Levy 2003; Comerton-Forde and Rydge 2006). As a part of the remedial actions that the stock exchange agreed to, this program was required to be in effect for a period of at least eighteen months and must monitor the activity of at least twenty NYSE stocks. The surveillance system was installed at each specialist's "post and panel" in order to capture trading activity occurring at these stations. The system intended to monitor the activity and interaction between each specialist and other Floor Members, as well as interaction between Floor Members. With the use of synchronized time clocks, it would be able to track trades and corroborate with the time-sequenced records of all orders arriving. Additionally, the NYSE was required to develop and implement a system to track "(a) the identity of specialists and their clerks; (b) the times during which each specialist acts in his or her capacity as specialist on the floor of the NYSE; and (c) the times during which each specialist's clerk acts in the capacity of clerk to a specialist on the floor of the NYSE, and shall file any necessary proposed rule changes with the Commission" (SEC 2005b).

This pilot program remained in place until 2009 when the SEC consented to the cessation of the program. Upon "independent evaluation" by Commission officials, the program was deemed to have "played a helpful role in supplementing the NYSE's routine surveillance, examination, and enforcement programs" (SEC 2009b). The SEC agreed to the termination of this pilot program in order to allow the NYSE "greater flexibility in determining the appropriate regulatory usage of its audio-video surveillance technology

and data to maximize the potential benefit to the NYSE's surveillance, examination, and enforcement process" (SEC 2009b). In effect, the SEC was handing over control of surveillance to the very targets that it was intended to regulate.

The literature available on this pilot surveillance program demonstrates how little media and public attention has been paid to this SEC sanction. Aside from the official orders released by the SEC, the information that is publicly available about this initiative in various news sources consistently adheres to the official statements provided by the SEC on this subject without further exploration of the surveillance program itself (SEC 2005b; Levy 2003; Neilan and Moynihan 2005). Aside from the lack of critiques offered, it appears that the program was little known in academic streams. Not only was this program eventually discontinued, but the future surveillance initiatives that the NYSE has taken upon itself have little to do with the audio and video surveillance that the SEC had imposed upon it in the first place. In fact, the SEC had prompted the NYSE to continue without ordering any changes in its policies and practices, as the self-regulatory agency it was prior to the charges.

Self-regulation, encouraged by government legislation, has long been in operation within stock exchanges. For example, Soederberg (2008) contends that the Sarbanes-Oxley Act 2002 was interpreted by the SEC to be favouring self-regulation. Commentators argue that the benefits of self-regulation are: self-regulation may avoid the bureaucracy of a centralized state agency; SROs may have a better understanding of the securities industry than government regulators; self-regulation avoids the governmental costs of SEC oversight; and such SROs can be trusted to enforce their rules because exchanges have competitive pressures to protect investors through enforcing rules (Ellis, Fairchild, Fletcher 2009). In Braithwaite's (1982) model of enforced self-regulation,

internally developed rules of compliance are evaluated and approved by relevant regulatory agencies, and enforcement of these rules is left largely up to the corporation. “The concept of enforced self-regulation was developed in response to problems associated with government regulation of businesses and the recognition that a significant percentage of businesses will not voluntarily self-regulate. Enforced self-regulation combines the benefits of voluntary self-regulation with the coercive power of the state” (Simpson 2002: 100). Effectively, although a federal regulator from atop the regulatory hierarchy had ordered the NYSE to adopt specific regulatory measures, when left to its own regulatory devices, it returned to the forms of market surveillance that had failed in the past. Enforced self-regulation has been heavily relied upon as a form of surveillance until recently, as there has been a push by the new government and legislative reform for greater external regulation from government regulators. More recently, the SEC has announced a proposal to tag high-frequency large-volume traders with ID numbers and this allows the SEC to track their trade information (SEC 2010f; Younblai and Spicer 2010). This initiative comes five years after the initial order imposed by the SEC in which the NYSE was to identify its traders and their activities. The proposed system would assist the SEC in analyzing the trading activity of its market participants.

Before the Order by the SEC for the NYSE to identify specialists, the only surveillance of the trading floors that could be found existed with the NYSE’s predecessor, the American Stock Exchange (AMEX). A video surveillance system that rotated 360 degrees allowed the camera “to zip to anything from watching a clerk eat a burger to catching the ‘veloce’ movements of a runaway market” (Duffy 1998). This video was to be streamed live and accessed through the AMEX web site as a tool to bring public attention to the stock exchange. Upon AMEX’s acquisition by NYSE Euronext,

further mention of this tool disappeared, along with the actual technology on the NYSE website, without justification or a report as to why.

As far as surveillance technology goes, the NYSE claims to take great care to record and monitor individual actions taken by trading specialists. The computer program that it uses applies over “300 formulae to the reports generated by member firms or from NYSE surveillance. NYSE uses these formulae to specifically identify trades by the specialists that exhibit characteristics it has identified as consistent with rules violations” (Bove 2008: 1362-1363). Furthermore, the NYSE uses Display Book, which allows a specialist to view and execute available orders, provide price quotes and trade information, and monitor the profit or loss accruing to their firms’ proprietary account. Screenshots of Display Book depict keystrokes used by the specialists as a digital footprint of their trading activity. The screenshots are a pictorial representation, showing every keystroke of how violative interpositioning traders are entered into the Display Book (Bove 2008).

The NYSE’s pilot surveillance program remains a failed initiative on the part of the SEC to regulate the stock exchange. Not only was the regulator unable to maintain a surveillance system to monitor the NYSE, but it eventually released the stock exchange of its obligation to be centrally monitored, favouring self-regulation instead. In respect to surveillance as it has operated within conventional crimes, there have been few targets of surveillance that have been “let off the hook” in terms of monitoring. Those caught on surveillance cameras in crimes such as theft or murder are often prosecuted, whereas corporations are left up to their own self-regulatory devices, as described above, in terms of surveillance. Foucault (1977) originally saw panoptic surveillance as a way to “transform individuals such that they shape their behaviour in prescribed directions” (27),

however in this case, the subjects failed to be “transformed” by those who monitor them. The termination of this surveillance program is not surprising given the current treatment of white-collar crime. Needless to say there have been few initiatives to remove surveillance cameras from the street corners they closely monitor, which number in the thousands in New York City, and up to the millions in cities such as London, England. Furthermore, there have been few instances of turning surveillance over to the subject to allow for more “enforced self-regulation.”

The SEC’s Market Abuse Unit

Following the latest financial crisis to strike the United States, the SEC announced five new specialized investigative groups in its Enforcement Division. The Market Abuse Unit (MAU), based out of the SEC’s Philadelphia office, is one that will focus on “investigations involving large-scale market abuses and complex manipulation schemes by institutional traders, market professionals, and others” (SEC 2010h: January 13). In particular, it aims to detect complex insider trading schemes that contribute to the loss of millions of dollars. It is the SEC’s attempt to develop highly specialized investigators with the skills to detect market manipulation. By using market surveillance tools that are above and beyond the usual tools used by most self-regulatory organizations, the Market Abuse Unit attempts to be, and has been successful in certain instances²⁰, the champion over advanced market abuse.

Despite its successes, the MAU lacks audio and video surveillance technology such as that which the SEC had imposed upon the NYSE, yet it brings its own form of surveillance to detect market abuse, particularly insider trading. A large portion of the

²⁰ In one of the successful cases, the MAU performed an analysis of trading patterns of several companies during an insider trading scheme that involved Nicos Stephanou and UBS investment bank that had profited more than \$11 million (Goldstein 2010).

MAU's investigations are conducted by computers, which cross-check trading data with personal information about individual traders, such as their educational background and employment history. With this information, investigators are looking across multiple securities for patterns of behaviour by traders. Operating on the principle that insider information is spread through the personal and business networks of traders, the MAU then tries to determine whether those trading within the same securities are "simply smarter and luckier than other investors, or have benefited from improper access to confidential information" (Goldstein 2010). Historically, the SEC began its investigations using tips received from informants or referrals from a market surveillance team; however they are now taking a more proactive approach to detecting market abuse facilitated by evolving technology.

The MAU is one of the newest initiatives implemented by the SEC as a part of its "crackdown" on Wall Street. The unit obtains information gathered through its national databanks and through such firms as Dun and Bradstreet (<http://www.dnb.com/>) as a part of their surveillance efforts. Through what Gary Marx (1988) called "the new surveillance" back in 1988, information is gathered across all aspects of life and transcends distance, darkness, physical barriers, and time. "Powerful new information-gathering technologies are extending ever deeper into the social fabric and to more features of the environment" (Marx 1988: 207). He argues that one of the characteristics of "the new surveillance" is that it is often involuntary. In the case of the MAU, information that has been offered by business executives, in efforts to establish business contacts and reputations may be used against them through a form of market surveillance. This is similar to the ways that the disadvantaged classes often have employment history, along with any previous criminal records used against them. The powerful classes often

have little in common with the disadvantaged, however in this case they are both subjects of the “new surveillance.” The MAU is an excellent example of Marx’s “new surveillance” regime. “Rather than focusing on an isolated individual at one point in time and on static demographic data such as date of birth, surveillance increasingly involves complex transactional analysis, interrelating persons and events” (Marx 1988: 208). It is specifically in this way that the MAU operates to detect manipulations in the market. Cross-checking personal histories with market events allows them to spot patterns and in securities trading that may be determined to be market abuse.

Aside from investigations based on background checks, market surveillance teams also use complex algorithms to track trading patterns. In the U.S. each stock exchange, as a self-regulatory organization (SRO), is responsible for its own electronic monitoring of stocks. Each has a market surveillance division which dedicates staff time and resources to monitoring, in real-time, the day-to-day volatility of trades. The market surveillance divisions of stock exchanges often work closely with the Financial Industry Regulation Authority (FINRA) and the SEC in developing and managing their surveillance systems to identify weaknesses. In order to keep up with the speed at which trades are made, enforcement staff use surveillance software—programs designed to generate alerts for anomalies—either developed within each of their respective divisions, or contracted out to surveillance software companies. These alerts are not based on single trades; rather they are based on trading patterns and are programmed to find patterns which demonstrate potential manipulative practices (Davis and Ord 1990; Cumming and Johan 2008). However, these programs have limits. Williams (2009) contends that short-term trading patterns may overshadow any long term patterns, focusing instead on sudden “bursts of abnormal activity.” Furthermore, the parameters for what defines “normal

trading activity” are based on a set of market integrity rules and the sensitivity of the alerts can be managed. The alert system can be altered to fit operational constraints, that is, the number of alerts that can be investigated (Williams 2009: 470). In Canada, Market Regulation Services, which is used by the Investment Industry Regulatory Association of Canada (IIROC), performs electronic monitoring for the TSX and other exchanges, and acts in a similar fashion; as does the SMARTS Group in the UK which performs market surveillance for the London Stock Exchange.

Cumming and Johan (2008), in comparing global market surveillance systems, observe a number of factors that must exist in order for the systems to be effective in detecting market manipulation. First, in order to set the parameters for what “abnormal” trading activity looks like “normal” trading activity must be established. This is to minimize false positives in the alerts. Second, the surveillance program must be able to identify the activity of each market participant and be able to replay the entire record of orders and quotes. Third, the staff must be educated and trained about the issues being investigated since surveillance “depends on the quality of the software used and the degree to which the surveillance staff are educated and trained with regard to using the information provided in the alerts” (465). Fourth, the effectiveness of a surveillance system also depends on the “degree to which market participants are informed about the surveillance activities” and how they act in response. Fifth, for cross-market surveillance, surveillance effectiveness depends on the extent to which “information is shared across jurisdictions” (465), between markets within the same nation as well as internationally. Sixth, the efficiency of the surveillance system depends on the general regulatory framework at the time (465). Thus, with so many conditions upon which effective surveillance is contingent, the amount of market abuse discovered through this medium is

limited. For this reason, regulators must also rely on alternative means to detect market manipulation such as tips and complaints, and other surveillance tools such as wiretapping to gather evidence.

Wall Street and Wiretaps

2008 marked yet another financial crisis. Only six years after the bursting of the technology bubble and as many years after the passing of the Sarbanes-Oxley Act of 2002, another crisis, built of a stock market crash, the collapse of the housing market and the bankruptcy of large financial institutions, hit. Major financial frauds soon came to light, such as the Ponzi scheme perpetrated by Bernie Madoff (as described in the Literature Review). Fighting through a recession triggered by this crisis, the U.S. government provided massive bailouts to faltering firms, and then sought to pass legislation that demonstrated to the public that it was taking financial misconduct on Wall Street seriously. The SEC and key government players were criticized for not anticipating the crisis and as the economy slowly recovered, the SEC was bestowed with more funding and greater resources to begin the “crackdown” on Wall Street and white-collar crime. Since then, the SEC has become more active in its investigations, making the news on several occasions as it laid charges against firms and financial experts for an onslaught of manipulative practices that were being discovered.

On October 16, 2009 hedge fund manager and billionaire founder of Galleon Group, Raj Rajaratnam, was arrested on charges of insider trading. He and at least twenty others involved in the scandal, it is claimed, had generated no less than \$52 million in illegal profits through a massive insider trading ring (Ando 2009; Dai, Massoud, Nandy and Saunders 2010). The FBI alleges that Rajaratnam and others “repeatedly traded on material, non-public information pertaining to earnings forecasts, mergers, acquisitions,

or other business combinations” (FBI 2010b). A complaint filed by the SEC alleges that “Rajaratnam paid bribes in exchange for inside information about corporate earnings or takeover activity and then used the non-public information to illegally trade on behalf of Galleon” (SEC 2010i). Both agencies have pursued criminal and civil charges against the managers. As a part of the investigation into this case, the FBI utilized court-approved wiretaps to listen in on cellular phone conversations between Rajaratnam and his associates, as well as using consensually recorded conversations with an individual who became a cooperating witness in the case (FBI 2009b). These conversations revealed the fund managers sharing insider information as well as making efforts to hide their actions and evade detection. This case marks the first use of wiretaps by law enforcement to detect insider trading. Since the revelation of the use of this tool, Rajaratnam’s defence attorneys have been working to suppress the submission of wiretapped conversation into evidence, citing constitutional violations in obtaining the warrant. They claim that investigators misrepresented the urgency of the need for a special waiver to tap the defendant’s cell phones for an extended period of time, and overstated the credibility of its primary witness in the case (Kouwe 2009; de la Merced 2009). In November 2010, a federal judge ruled that the wiretaps could be used as evidence against Rajaratnam, who has pleaded not guilty to his charges (Bray 2010).

This case launched the beginning of the “crackdown” on insider trading. Since the courts permitted the use of wiretaps to detect such crime, investigators have allegedly begun to use this tool as a part of a wide-ranging case against several other members of the investment industry (Wyatt 2010). In another example of how business networks (particularly between experts in the industry) are often crucial to the commitment of financial crimes such as insider trading, investigating these associations has become a key

focus of law enforcement (Rothfeld, Pulliam and Bray 2010). The message sent through the financial industry was clear: this was only the start of things to come. This early warning signal will of course alert financial experts to be more cautious in their communications.

Wiretapping as a surveillance tool

In the early days of wiretapping, a recording device had to be placed on the telephone line (Diffie and Landau 2007). However, with the advancement of technology, wireless surveillance can be employed through picking up a radio signal or intercepting calls through the telephone company's network. With court authorization, law enforcement agencies can also access mobile phone networks to intercept cellular phone calls. Wiretap use is governed in the United States by Title III of the Omnibus Crime Control and Safe Streets Act of 1968, also known as the Wiretap Act. Under the Wiretap Act, the use of wiretapping was only permitted with judicial authorization, and in order to obtain this, certain guidelines must be met and followed. Before the USA Patriot Act was enacted in 2001, one of the most crucial of these guidelines in the Wiretap Act required authorities to have probable cause and required them to show that "alternative techniques have failed, are unlikely to succeed, or will be too dangerous" (Wiretap Act 1968 §2518(1)(c)). The U.S. Patriot Act 2001 subsequently amended this Title and allowed for "roving wiretaps" in cases of suspected terrorism, which would be obtained without a court order (USA Patriot Act 2001). Critics of the use of wiretapping for white-collar crimes, such as Rajaratnam's defence lawyers, argue that such crimes are, by definition, non-physical, and therefore non-violent, which thus should defeat the request to obtain a wiretap. However, according to Nunn (2008), wiretapping is ideal for "language crimes" in which the offence requires interpersonal communications in order to conspire to

commit the crimes. Insider trading, by nature, involves the covert communication of insider information through various channels. Those who are cautious not to leave a “paper trail” often transmit this information through phone calls, which can now be “tapped” by law enforcement agencies.

Nunn (2008) further describes the guidelines to wiretapping that must be followed by law enforcement. Certain procedures must be adhered to when monitoring conversations, specifically in order to preserve constitutional rights to privacy. One of these guidelines is that of minimization, in which conversations that are intercepted, and the number of people to whom this information is revealed, must be limited. Furthermore, the listening rooms which hold the monitoring personnel should be secured and the number of personnel within the rooms should be minimized (346). Since wiretapping is “indiscriminate” in the conversations that it listens to, all communications on the phone line are consequently intercepted; even those of innocent parties who are not involved in the crime (Freiwald 2004:18). Thus the privacy of individuals who are innocent of the crime, and not subjects of the court-authorized warrant obtained, would be unnecessarily violated. For this reason, another guideline requires that police specify in their warrant application the parties who they perceive to be involved in the crime and who will be the subjects of the wiretap. The Galleon case, along with the insider trading cases that followed, relied on tips from insiders of the ring to obtain this information in order to obtain a warrant (Merced 2009). With the subject listed on the warrant, communications must then be carefully monitored. Since not all communications will be of criminal significance, the listeners are permitted to monitor an intercepted conversation every two minutes for thirty seconds unless the conversation is of significance to the case (Nunn 2008).

Wiretapping operates differently from the CCTV cameras that are a more common form of surveillance. It is a technique that can only be used when a crime is suspected of taking place, and attempts to catch the culprit in the act. It is their hidden nature—or in the wireless sense, their invisibility—that in general makes them a safer technique for law enforcement to use than inserting an undercover officer into the operation (Ando 2009). There is a lower risk of discovery and harm. Informants, such as those in the Galleon case, have also been known to wear recording devices hidden on their persons to record conversations with participants in the insider trading ring (Wyatt 2010). In fact, unlike CCTV cameras, this form of electronic surveillance cannot be effective unless it is hidden, due to the nature of the information that it is attempting to capture. If a wiretap is revealed, subjects will avoid revealing criminal activities or engage in ‘counter-surveillance’ techniques such as avoiding phone lines, using disposable cell phones, or encrypting the language that they use in their conversations (Freiwald 2004). However, while wiretaps are useful for gathering evidence, they only have a deterrent effect once their use is revealed. With the possibility of law enforcement overhearing their private business conversations, subjects may be deterred from having these conversations altogether. Nonetheless, the possibility remains that they may seek alternative means of obtaining and sharing information altogether.

Although wiretaps have been primarily used to detect conventional crimes, the same guidelines will be applied to their new use in the corporate realm. In fact, as demonstrated by the Galleon case, law enforcement will need to take great caution to follow all legal procedures for obtaining and employing this tool, as the subjects of this form of surveillance wield powerful weapons in the form of high-priced lawyers—a luxury that most other subjects of surveillance cannot afford. Moreover, this created, for

the first time, the potential that business information, long protected by laws guaranteeing confidentiality, might now be open to surveillance by law enforcement.

Though I have discussed only the United States up to this point, this situation has parallels in other countries with equally intricate financial markets. The use of surveillance in the Galleon case has sent reverberations into the international community. As the United States becomes more aggressive in its pursuit of insider trading, the United Kingdom has also joined the quest. The Financial Services Authority (FSA) which is the regulator of all financial services providers in the UK, has recently announced its intention to require firms to record the cellular phone conversations of its employees. The UK, already home to one of the largest street surveillance efforts, currently records communications through office land lines, e-mail and messaging systems. In November 2011, when this new initiative will take effect, the FSA predicts it will have approximately 16,000 mobile phones of financial employees under surveillance as well (BBC 2010; Jones 2010; Werdigier 2010).

Conclusion

There are drastically more financial resources available to the SEC now than there has been in the past. In fact, 2010 saw the greatest budgetary increase the SEC has ever received, due to the passage of new legislation (the Dodd-Frank Wall Street Reform Act 2010) that made financial regulation a priority in the United States. Compared to the resources that were available to the SEC in the years leading up to this new law, the regulator may see a dramatic increase in the authorized funding it has received, an increase in the number of staff that it employs, along with an extension of its regulatory powers. The FBI, making recent headlines by arresting and charging important financial executives, also appears to be employing new techniques and turning more attention to

white-collar crime. Critics draw attention to the political climate at the time of any regulatory crackdown or reshaping of regulatory law (Friedrichs 1996; Snider 2008; Haines and Sutton 2003) Friedrichs (1996) notes that “the incumbent administration’s political ideology significantly shapes the extent and scope of the agency’s response to this type of crime” (274). This will be further explored in Chapter 4.

Chapter 4

Barriers to the Use of Surveillance in Corporate Crime

Introduction

With surveillance tools so predominantly used in the area of detecting and enforcing traditional crime, this thesis questions why it has so slowly and cautiously entered the realm of enforcing corporate crime. The previous chapter examined the two dominant enforcement agencies, the SEC and the FBI, and the types of enforcement tools that are available to them. These tools have been supported by government statutes and have evolved over time due to changing attitudes in government intervention in matters of the stock market. However, despite the increase in the use of surveillance on the streets and against conventional criminals, “No surveillance cameras have been installed in executive boardrooms, no police, forensic accountants or regulatory officials have been empowered to routinely do ‘panoptic sorts’ or digitally mine the online activities of CEOs” (Gandy 1993; Snider 2010). The three examples described in the previous chapter are the few instances where surveillance has been employed as a tool to monitor and detect financial crimes²¹.

Even when a crime is detected, governments have been described as reluctant to criminally charge financial firms with wrongdoings (Pulliam and Perez 2010). This is, in part, because the accusation of a crime can cause businesses to implode as clients will refuse to trade with the firm and investor confidence is effectively destroyed. In fact, the mere suspicion of a regulatory infraction is often enough to ruin careers and reputations.

²¹ From the research that has been conducted for this thesis, these examples appear to be the *only* instances of the use of surveillance to address corporate crime.

As demonstrated by the now defunct Arthur Anderson, accounting firm for the bankrupted Enron, no major financial firm has been able to survive criminal charges (Pulliam and Perez 2010). In a Wall Street firm, its people are its assets, as the firms have no hard assets to fall back on. Thus reputation is important and the act of one person can often damage the reputation of the entire firm beyond repair (Banks 2004). Added to this risk is the fact that these corporations are well-connected to top politicians who determine their budget, and thus regulators “tread lightly around well-networked corporate actors and avoid targeting major corporations without ‘solid evidence’” (Snider 2009: 191-192). It has been apparent that governments are much more careful about ruining the reputation of powerful individuals and firms than they are about people in less powerful positions. This is one of the reasons that the SEC investigative process has historically been described as “devoid and methodical” (as described in Chapter 3) with little urgency on the need to criminally prosecute crimes (Ryan 2010). Elsewhere in the criminal justice system there appears to be a rush to judgment against less powerful members of society such as welfare mothers and delinquent youths (Coleman and McCahill 2010: 53).

Coleman and McCahill (2010) have described surveillance as having a “light touch” on corporate crimes. “[The surveillance used] is ‘light’ in the sense that it has less enforcement power, less resources, and less of a punitive gaze than the forms of intense and often heavy handed surveillance [of conventional crimes]” (129-130). The authors also maintain that it is “light” because powerful groups, as those who design and implement the tools, are able to use their influence “to shape surveillance practice” (130). This fosters an environment that encourages cooperation, compliance-based and self-regulatory approaches to surveillance over the powerful. In this chapter, I will explore this “light touch” of surveillance by examining the five barriers that exist to the regulation

of corporate crimes. I have identified these barriers as cultural, political, economic, legal and technological. In particular, I will look at how these barriers make the corporation an unattractive environment for regulators to implement new enforcement tools such as surveillance technology. Barriers, in this thesis, are defined as factors that can either affect the implementation of regulatory initiatives such as surveillance, or those that have influenced the effectiveness of surveillance as tools of enforcement. It is important to note that there is much overlap between these five categories and they tend to work concurrently and interactively. Therefore, in the discussion to follow, many of the issues that I introduce are a result of multiple barriers to regulation. They are categorized in this thesis as an organizational device, however there is significance to their multidimensional, overlapping effects.

The first section will look at the cultural barriers to surveillance. The financial industry, specifically investments and investment banking, is known for risk-taking and its culture of competition and masculinity (Zaloom 2006). It is a profession that is admired particularly for these traits. These cultural characteristics, I argue, make it difficult for surveillance to be effective in altering the behaviour of corporate actors as subjects. In Section II, I will examine the political barriers and the long-standing ties between business and government. This “incestuous” relationship plays a major role in the construction and passage of legislation on government regulation in the financial industry. Moreover the “revolving door” between government and the financial industry plays an important role in the regulation of corporations. Section III looks at the economic barriers which influence, and are influenced by, the political barriers. Corporate interests affect campaign contributions for political officials who have a vote in passing legislation. Furthermore the political agenda at the time influences the amount of

resources that are directed at particular law enforcement agencies, as we saw in Chapter 3. Section IV takes a look at the legal barriers in the form of legislation that has either increased or limited regulators' powers. As each financial disaster has resulted in its own "regulatory legacy" (Haines and Sutton 2003), the investing public has been reassured time and time again that "this time is different" (Reinhart and Rogoff 2009). Yet it is often only a matter of years before this is proven untrue. Finally, Section V will discuss the technological barriers, which have greatly advanced over time and changed the environment of trading and regulation. Despite any legislation that would give regulators the legal permission to pursue financial crimes, stock markets and investment firms are constantly developing newer and faster technology, making it difficult for regulators to simply catch up in the high frequency "arms race" (Gehm 2010).

Section I: Cultural Barriers

The use of surveillance has traditionally aimed to enforce self-control in populations. In Bentham's original design of the panopticon prison, surveillance was designed to create a sense of self-discipline in the prisoners (Foucault 1977). However, the use of surveillance in corporate crimes faces a barrier in the form of a prevailing corporate culture of competition, risk-taking and self-confidence. As such, these characteristics—common and dominant among corporate actors—make it difficult for business executives and entrepreneurs to accept external, particularly governmentally imposed, limits. As discussed in the Literature Review, the accumulation of wealth was accompanied by the accumulation of power, with which certain groups were able to shape the law to reflect their own interests (Sutherland 1961). This influence of powerful groups over the government impacts the likelihood of corporate actors to be controlled as

subjects of regulation through surveillance. It is for this reason that I will examine the corporate culture of the financial industry and assess its suitability for regulation.

Jobs in corporate finance and investment are known as careers that have commonly recruited young and ambitious business school graduates. In the area of trading, young²² educated males dominate the field and have consequently produced a culture of masculinity that has not been described as “female-friendly” (Zaloom 2006; Fenton-O’Creedy et al. 2005). In general, Wall Street is known as a “boys’ club” which is run at the top by older men, groomed into their positions from the moment they enter the field as young business graduates. As they rise to the top, they become, like those before them, “men who have been in the business a long time and have very firm ideas about the way the world works” (Banks 2004: 114). Thus in a career where social networks bring opportunities, *who* you know has become, in many cases, more important than *what* you know. The corporate culture of the investment industry is aptly captured by Zaloom’s (2006) description of the “economic man”: traders in the pit are aggressive, competitive, fiercely independent, and often crude (111). In her ethnographic study of the trading pits of the Chicago Board of Trade, she describes the dominant language there as consisting mostly of metaphors of the body, along with “violent images of sexual domination [that] destroy the sovereignty of the individual, subjugating his body to the will of a competitor” (123). Financial losses were described in bodily terms of sex and violence; associations with other men, often dialogued through insults, focused on masculine domination and the homosexuality of one’s trading neighbour (122).

Her findings coincide with earlier studies that have argued that successful people in business—as well as white-collar offenders—are more likely to possess a tendency

²² According to Fenton-O’Creedy et al. (2005), thirty-five is generally the ceiling for the age of traders.

toward risk-taking and recklessness, ambitiousness and drive, egocentricity and a hunger for power (Snider 1993; Friedrichs 1996). Hierarchy, in the financial industry, as in every hierarchy, awards considerably more money and power to those at the top of the corporate ladder than to those at the bottom. This provides incentive for those lower level employees to work harder to reach the top. In this line of work, where the dominant ideology is individualism and the achievement of success, the alpha male personality is most successful and therefore most admired²³. As such, when governments attempt to regulate these higher level subjects, they find themselves up against levels of resistance that those in lower-level jobs may not be able to provide (Laufer and Robertson 1997). Any government regulation that attempts to restrict or put limits on the behaviour of these corporate actors is seen, predominantly by these actors, to go against the dominant culture of competition and success that are major tenants of capitalism.

Another aspect of the corporate culture is one of self-discipline. The traders of Wall Street employ their own methods of “self-regulation” due to the nature of their jobs. In the investment industry, the traders are at the bottom of the workplace hierarchy below the many rungs of corporate executives above them. However, every day these traders make hundreds of trades worth millions of dollars to themselves and their employers. Thus they have been allowed to enjoy almost complete freedom from intrusive levels of surveillance. Although they are often at the source of many financial scandals,²⁴ traders are crucial players in the investment industry as they hold the key to the future of large sums of money. As such, they are among those whose “expert views” are in high demand

²³ This dominant risk-taking personality was seen among many of the top executives of the now-bankrupt Enron. It demonstrated a danger-loving risk-taking persona that identified these males as “men with spikes” (McLean and Elkind 2003).

²⁴ For example: the “flash crash” was originally blamed on the “fat fingered” trader (Schapiro 2010); Enron traders were responsible for rolling blackouts in California in order to drive up the price of energy (McLean and Elkind 2003).

as they rise up the hierarchy into the position of managers and subsequently become “powerful and influential public figures” (Sjöberg 2004: 484). However, the downside of the crucial role that traders have is that when a scandal is found out and blame is assessed, blame falls disproportionately on “so-called ‘rogue traders’ ...not the economic system that supports and legitimates their acts (Levi 1993, 1995; Passas and Nelken 1993; Snider 2000). Zaloom (2006) showed that traders use their own techniques of discipline that “separates traders from the guiding principles of the outside world by differentiating the time and space of the market and creating a specific market being” (128). She contends that despite an “external performance of excess and recklessness, the internal performance of market action is governed by strict control over the highs and lows of emotion and is devoted to creating a self that is an instrument for reading the market and reacting to its every twitch” (125). There are four core elements to their discipline: separation of their actions on the trading floors with their lives outside; control over the impact of losses (upon themselves); dismantling narratives of success or failure of past trades to lessen the impact on conducting future trades; and maintaining acute alertness in the present moment (Zaloom 2006: 128). Thus, the effects of panoptic surveillance, initially seen as a tool to discipline the body, gives way to traders’ own self-disciplinary actions on the trading floor. The traders’ self-regulation, however, is driven by individualistic motivations, as this discipline is a way to protect themselves rather than serving to protect everybody else as government attempts to do. Nevertheless, traders, unlike the typical subjects of surveillance hold more power than the usual surveillance targets because, as noted above, their activities are distinctive and crucial to the continued profitability of their corporate employers. This gives them much more power to resist regulation (Reichman 1992).

In addition to the culture of masculinity and self-discipline, there is great emphasis within these investment-centered corporations on competition at the individual level. This “culture of competition” stems from, and concurrently generates, the idea that wealth and success are “central goals of human endeavour” (Coleman 1987: 416). Contributing further to this is a compensation structure that encourages risk-taking and competition (Knee 2006). Managers of some firms are accordingly given an interest in the company in the form of options to buy their own company’s stock at a given price. (Braithwaite 2008; Soederberg 2008). Before 1991, the Securities and Exchange Act of 1934 “required a senior executive of a publicly held company to hold the underlying security for six months after the exercise of a stock option” (Coffee 2004: 276). After 1991, the SEC relaxed the holding period for the stock, essentially allowing executives to sell the underlying stock on the same day. This provided managers and traders with incentive to push up the price of the stock, but as a result they suffered no losses when the stock price went down. Between 1992 and 1998, the median compensation of Standard and Poor’s (S&P) 500 chief executives thus increased by approximately 150%. Braithwaite (2008) and Shapiro (1990) contend that the lack of consequences in this sense led some managers and traders to partake in high-risk strategies, one of which was fraud. To maintain the appearance of a profitable company, some resorted to manipulating earnings on financial statements to bolster the price of the company’s stock. According to Dorn (2009), “[t]hese types of practices have been normalized amongst companies and commentators have merely credited this to the nature of the business and capitalism itself” (28). With compensation structures such as this—Banks (2004) describes the bonus recipe as “equal parts merit, favouritism and fear” (140)—the desire for monetary compensation along with the praise associated with achieved success, may outweigh the

desire to abide by the rules of ethical business (Snider 1993; Simpson 2002; Black 2010). Thus I would argue that the potential deterrent effect of any surveillance that is implemented is diminished due to the high reward of engaging in risky behaviour.

The sum of these privileges obtained by business executives results in corporate actors having greater “cultural capital” than conventional criminals and the less privileged classes who do not have a choice about whether to be under surveillance (Coleman and McCahill 2010). It is those in power, those with influence over the law or lawmakers (through political and economic factors discussed in the next two sections), who decide when and where to implement surveillance (Coleman and McCahill 2010). For example, as discussed in the previous chapter, the SEC decided to leave the surveillance decisions on the implementation and removal of the NYSE audio and video surveillance system up to the New York Stock Exchange. Although there is little information available on this event—which is a significant point in itself—this use of surveillance became an issue over which the SEC relinquished control. Moreover, the SEC justified returning control over regulation to the NYSE with the rationalization that the stock exchange could better determine its own surveillance needs. This demonstrates the criticism by Snider (2009) that corporations are assumed to have good faith, while “others”—the more conventional criminals—are policed. The solution to financial scandals has often been an assumption that corporations should improve their self-regulatory processes (Peters 2004; Weismann 2004; Soederberg 2008). Corporations are seen as being better able and better equipped to police themselves, even as they are required to have external auditors (Soederberg 2008). Self-regulation is thus assumed to be the more effective method, expressing the “light touch” of surveillance on corporations. Surveillance, in this sense, is just another tool that regulators lack the power to deploy and enforce. In particular, because surveillance is

intrusive and invasive, business actors can purchase privacy, put up their own barriers to restrict surveillance or circumvent it altogether.

As discussed in Chapter 2, Haggerty (2006) argues that it is the wealthy, powerful classes that obtain privacy rights. As such, those who are less wealthy have little influence over the surveillance used upon them and fewer opportunities for resistance. Those lower down—call center operators, fast food servers, warehouse employees, or bank tellers—have less autonomy, fewer privileges, and limited chances to determine the conditions of their employment (Ball 2003). If surveillance is one of those conditions (as it now frequently is), their choices are limited to accepting the conditions or refusing the job (Snider 2001). Or, as Kiss and Mosco (2005; 2006) have found, workers must rely on unions to properly negotiate the conditions of their surveillance. Surveillance technology in the workplace can track workers' whereabouts and every keystroke they make, and it is so complex that it is difficult (and may be illegal) for employees to resist or circumvent, particularly if they lack technical expertise. In contrast, governments often hold meetings with senior executives and CEOs, seeking input on how to best monitor and regulate corporations. The influences of the powerful economic actors extend through their social networks into the political sphere so that they are allowed input into their own regulation (Snider 2009). It is these conversations that “blue-collar criminals” are excluded from when decisions are made regarding their own crimes. Consequently the surveillance of these lower-level employees is not seen by their employers as a breach of employees' privacy rights but as necessary for an efficient workforce. In fact it is not seen to conflict with the dominant culture either, as the dominant culture among lower level employees often stresses conformity to company goals rather than individualism (Laufer and Robertson 1997).

The cultural and political barriers to surveillance are closely linked. With the powerful networks that wealthy and successful business actors have, they are able to influence lawmakers and regulators who propose and implement tools of surveillance. It is why the next section on political barriers, puts particular emphasis on the “revolving door,” the interchange of personnel between government and the corporation, as a dominant factor in the use of surveillance as a regulatory tool.

Section II: Political Barriers

The political ties between government and business date far back in history. Historically, being granted incorporation rights by the government was considered to be a privilege (Snider 2000: 171). After the rise of capitalism, this process has been reversed and it is now the government that is seen to benefit from the addition of a business to the economy. “Nations and their sub-units compete to offer business the best tax breaks, the highest subsidies, the lowest minimum wage levels, the least regulation” (Snider 2000: 171). At present, businesses are a major source of employment and they inject money into the local economy through their operations, thus the symbiotic relationship between business and government continues. There has also been a longstanding tradition of a “revolving door” between the two through which officials have reached their seats in government via their positions in powerful corporations and vice-versa (Shapiro 1990; Wiist 2010). Not only does the “revolving door” create ties between politicians and corporations, the door also spins in the direction of the ostensibly independent regulators. Thus, the “revolving door” in this thesis refers to three scenarios: the movement of former members of Congress to positions with lobbying firms; the movement of high-ranking corporate officials to government positions; and the movement of regulatory officials to corporate positions. In some instances, the direction of movement will be reversed but I

will discuss later on why this occurrence is rare. The “revolving door” is important because those who pass through have insider knowledge that can benefit their new employer. This section will also discuss the important influence that powerful and wealthy corporate elites have upon the law-making process. These ties between politicians and corporations have limited the reach of surveillance into the corporate world as a tool of regulation. Powerful groups, such as those in the corporate sector, as discussed below, use their political, social, ideological and economic capital to “legitimate their role as an inside player with the cultural authority to shape the meaning and interpretation of formal regulatory law” (Snider 2009: 180). Political ties also shape legal barriers to regulation but this section will focus on the “revolving door” between business and government and the impact that corporations have on their own regulation.

It is no secret that powerful groups—such as corporations, lobbyists, and special interest groups—have a close relationship with certain government officials and attempt to influence the lawmaking process. Powerful and influential people, be they in politics or business, are connected through various social and business networks. According to Friedrichs (1996), “organizations attempt, often with considerable success, to influence the legal environment within which they operate, to enhance the predictability and stability of their economic environment, and to shield themselves from civil and criminal liability” (221). The influence of corporations on politics may begin on the campaign trail as large businesses, with special interests, often make campaign contributions to support those candidates who they believe will serve their best interests (Wiist 2010; Center for Responsive Politics 2010). Once these officials have been elected, they often become access points for corporations to exert their influence over legislation. For example, Kenneth Lay (chairman and CEO of Enron) was among the powerful corporate actors

who contributed generously to the presidential campaign of George W. Bush (McLean and Elkind 2003). As described by McLean and Elkind (2003) “Enron’s businesses needed favourable rulings and legislation to thrive, and that meant it needed the government to institute rules and laws to help spur deregulation along” (88). Alvesalo et al. (2006) contend that powerful interests are potentially “threatened” by economic crime control initiatives and thus in order for these initiatives to take hold, political support must be rallied (20). However, supporters of economic crime control face tough competition from those whose interests are threatened, as they are often the source of financial support for elected officials. (The economic barriers that campaign contributions provide to the regulatory process will be explored further in the next section).

Unsurprisingly, then, these wide-reaching social networks often create the aforementioned “revolving door” between government, regulators, and businesses. Corporations and their regulators are unavoidably linked through connections forged through investigations of regulatory matters. Though these connections are not necessarily positive, particularly if a corporation is being pursued for an offence, contacts between people are nevertheless made. In the United States, the revolving door between regulators and the regulated corporations, more often than not, turns only one way: from those enforcing the rules toward those who can earn greater money attempting to circumvent them. That is not to say that all those moving from the regulatory industry into corporate positions are intent on breaking the rules they were formerly charged with applying. However, those in the regulatory industry have been well-criticized for using their jobs as a stepping stone into a better-paying corporate job (McGinty 2010a, 2010b; Heyes 2003). The fact that they are well-versed in the rules, and as a result, well-versed in how to circumvent them, adds to their attractiveness. To add to the incentive, the private

sector pays significantly more than they would earn in a regulatory organization. Historically, the regulatory industry has had a high turnover due to its inability to compete with better paying positions in the private sector (Berenson 2003). This goes a long way back: the original members of the SEC back in 1934 did not last long in their positions as most left within a few months to pursue more lucrative positions²⁵. Due to the high volume of movement between the regulatory industry and private industry, regulatory agencies can be “captured,” (Ayres and Braithwaite 1991; Braithwaite and Drahos 2000) in which the “initially independent regulatory agencies risk becoming the captive of those they are supposed to regulate, through repeated interactions with them” (Dorn 2009: 34). This can have grave effects on the regulatory process because, as McCaffrey and Hart (1998) point out: “Congress defers to the SEC’s judgments on rulemaking and enforcement more than it defers to other agencies...[giving] the SEC...substantial discretion in deciding who and what to pursue and how severely” (50). With the flexibility that the SEC has in deciding the cases it will pursue, a firm with a solid working relationship with the regulator has an advantage over a firm with a “shakier” one (McCaffrey and Hart 1998).

A similar door revolves between senior government appointees and private corporate jobs, one that affects the legislative decisions that affect business. Many of the top seated government officials have served time as executives or high ranking players in large powerful corporations. The former Secretary of Treasury in the Bush administration, Henry Paulson, was the former head of Goldman Sachs. The new chief of staff for the Treasury in the Obama administration, Mark Patterson, was also a top

²⁵ Ferdinand Pecora, a Commissioner, left after six months to become a judge for ten times his salary at the SEC; Joseph Kennedy (father of John F. Kennedy) was the first chairman of the SEC but maintained he could not afford to stay longer than a year (Geisst 2004).

lobbyist for Goldman Sachs. According to the Center for Responsive Politics, a total of twenty-five senior members of the Obama administration came from high-ranking positions on Wall Street. In the United States, former members of Congress are considered to be very valuable commodities to lobbying firms as they have many contacts on Capitol Hill and thus, their employers believe, they have the ability to influence legislation. Moreover, the connections that these well-known-former-politicians can offer are often as appealing to potential clients as to the lobbying firm (CFRP 2010). As a result, such firms may pay salaries ranging from \$300,000 to \$600,000 a year to entice former members of Congress to join their team²⁶. Critics believe that these connections have had significant influence on the regulatory legislation that has been passed or, more often, not passed. (The way in which connections have specifically affected legislation will be further explored in the Legal Barriers section however its significance will be noted here). They also question the morality of lobbying a government or agency that the official formerly worked for, particularly if that government includes former colleagues; or if Congress members carry with them specific inside knowledge of upcoming governmental proceedings. To address this potential conflict of interest, in 2007, following a series of lobbying scandals, a new rule was enacted that required a one-year “cooling off period” before members of Congress were allowed through the revolving doors into lobbying firms (McGinty 2010a; McGintyb). This rule also applies to high-level regulators, such as those at the SEC who have accepted positions at firms they used to regulate. Nonetheless, some former officials have managed to circumvent it by accepting roles as consultants or advisors for the lobbying firms during the one-year

²⁶ The Center for Responsive Politics counts 3,125 congressional staffers who have lobbied in 2009.

“cooling off period” then coming on board as full-time lobbyists at the end of this period (CFRP 2010).

Power differentials play a large part in explaining these political barriers. There is a power differential between large corporations and government officials, between government officials and regulators, and between regulators and those they regulate. In all three cases, one side is able to exert more influence than the other side: the corporate sector typically has many ways to exercise power over politicians and other government officials; senior levels of government control the resources that regulatory agencies receive; and regulators, while they have formal, legal power, often appear to have little influence over those they regulate. This is in stark contrast to traditional criminals, who typically have little bargaining power and little influence over the laws and politicians that affect the surveillance and sanctions they receive. Government and law enforcement agencies are more easily able to implement enforcement tools such as surveillance to monitor these criminals because they lack this essential bargaining power. Corporate executives, on the other hand, have managed to keep surveillance out of their boardrooms and executive offices (Snider 2010) for a number of reasons, but perhaps the most important factor is through money. Money comes into the economy through the activities of the corporation; business creates jobs and generates tax income, which helps fund government payrolls and programmes. Glasbeek (2002) discusses one of the best-known examples of the corporate stranglehold on government: the production and sale of tobacco. Despite numerous studies that provide evidence of its harmful effects on health and subsequent moral objections by copious social interest groups calling for smoking bans, governments have yet to entirely prohibit tobacco sales. This has been predominantly thanks to a very powerful tobacco lobby, the sponsorship by tobacco of

major sporting events, and the reliance of local and national governments on revenue from the taxation of tobacco products. Whether governments here are yielding to corporate pressures or pursuing their own fiscal needs, and regardless of popular and scientific opinion, these products have been allowed to remain on the market

As regulators are held accountable by the government—the SEC was created under the authority of Congress—they often find their authority restricted by the actions of certain politicians who oversee them; politicians who are often “beholden” in important ways to the very businesses the SEC is charged with regulating (Geisst 2004). In addition to this, the SEC Chairperson and five Commissioners are appointed by the President of the United States, with approval by the Senate²⁷. Under the authority of the government-appointed executives and the Treasury, regulators cannot avoid indirect corporate influence. In fact, when legislators are drafting legislation and decide to leave the specifics and details to the regulators to decide, as they frequently do, the regulators often seek input from the corporations they regulate. Furthermore, major lobby firms ensure that while legislators may not seek input from the public, they will still hear from the major corporations through the lobbyists they have hired.²⁸ These ties between government, regulators, and corporations are important political barriers to regulation because these connections impact the employment of surveillance in the industry.

Business’ influence over politicians also impacts government finances and spending. Although this will be further explained in the Economic Barriers section, it is worth noting here that governments control the budgets of the regulators. A change in the

²⁷ To ensure non-partisanship, no more than three out of the five commissioners may belong to the same political party (SEC 2010d).

²⁸ Insurance companies, pharmaceutical firms and hospitals are among the interest groups who have spent \$380 million lobbying against Obama’s healthcare reform plan in 2009 (McGreal 2009).

U.S. government in 2008 from the business-friendly Republican government—who historically favoured no government regulation and sweeping corporate tax cuts—to the more moderate Democratic Party produced larger regulatory budgets in a number of sectors (Protest 2011). The 2011 budget of the SEC was set to go up to \$1.258 billion, a significant increase from the 2010 budget of \$1.119 billion (SEC 2010i: 2). Budget increases have become a way for the SEC and federal government to demonstrate to the public that they were taking definitive action against market abuse doing everything possible to prevent future financial scandals. After the November 2010 mid-term elections, however, the U.S. Congress became dominated by newly elected Republicans, who immediately began making cuts to the newly-passed Dodd-Frank Wall Street Reform Act and freezing the budget increase for the SEC (Clarke and Younglai 2010). As discussed in Chapter 3, the main law enforcement agency for criminal law enforcement is not the SEC but the FBI. In the 1970s an increase in resources for the FBI signalled the government’s desire to “crack down” on corporate and white-collar crime. However, under a Republican regime through most of the 1980s, resources were shifted toward a “war on drugs” (Simon and Swart 1985; Poveda 1999). After September 11, 2001, white-collar crime resources were redirected toward anti-terrorism and there were repeated denials of budget requests for corporate law enforcement (Litchblau, Johnston and Nixon 2008). The 2008 financial crisis redirected resources towards white-collar and corporate crime, but as discussed above, it looks as if this resurgence will be short-lived (Quick 2010).

The Political Barriers section has discussed the “revolving door” as a mechanism through which actors in the regulatory, corporate and political realm are inextricably linked. Given that politics and money are related, political barriers to surveillance are

often exemplified through the amount of funding available. The following section will expand on these economic barriers to effective enforcement and surveillance.

Section III: Economic Barriers

Economic barriers to effective regulatory surveillance overlap with political barriers, particularly when discussing the economic benefits received by corporate-friendly politicians and favoured political parties²⁹. Benefits come in the form of campaign contributions before, during and after election season (opencongress.org). Corporations also have the ability to defeat a politician that business dislikes through overt means by providing massive support to his or her rival, or more frequently, through covert funding directed through disguised interest groups (Glasbeek 2002). It is no surprise then that when it comes time to vote, politicians backed by certain interests groups frequently vote in line with corporate interests.

Economic barriers also exist in the form of changes in budget allocations to regulators. Forced to adjust their operational budgets as governments change, regulators have alternately seen their hands tied by more business-friendly regimes, and been granted increased funding by pro-regulatory administrations. This section “follows the money” from the campaign contributions to legislators to the economic resources received by regulatory agencies. By examining the economic inequalities in the regulatory equation, I will demonstrate how those who support regulation, and such regulatory tools as surveillance, are out-financed by those who oppose it.

²⁹ Both mainstream parties in the U.S., the Republicans and the Democrats, are heavily dependent on corporate contributions. Between 1989 and 2010, the top three contributors to political campaigns were AT&T (\$45.6 million), Goldman Sachs (\$36.7 million) and Citigroup (\$27.5 million). All three corporations donated to both Republican and Democratic candidates (Watson 2010; CFRP 2010).

The Dodd-Frank Wall Street Reform Act (Dodd-Frank Act) is the most recent and significant piece of legislation to be passed by the American government since the 1930s. Largely supported by the Democrats and largely opposed by the Republicans, opencongress.org gives a detailed look at how each politician involved in the process voted on this particular Act. Opencongress.org is a non-profit independent organization that tracks campaign contributions, the passing of legislation and votes, revealing the ‘money trail’ between interest groups and members of Congress. In the case of the Dodd-Frank Act, the top interest groups supporting this Bill were consumer groups and “elderly issues/Social Security” groups; specific organizations identified as supporters are the Consumer Federation of America and the American Association of Retired Persons. On the other side, interest groups who opposed the Bill were commercial banks, bank holding companies and credit unions. Particularly fierce opposition came from the American Bankers Association and the National Association of Federal Credit Unions (opencongress.org 2010). Despite the fact that both sides of the vote saw support from a variety of organizations, the groups opposing the Bill—banks and credit unions—were far more powerful than those supporting it, retired persons and consumers. However, due to the Democratic Party’s majority in both the House of Representatives and Congress at the time, the Bill passed on July 21, 2010. It was almost unanimously opposed by Republican members. The three Republican supporters in the Senate, Susan M. Collins, Olympia J. Snowe, and Scott P. Brown³⁰ (Cooper 2010), were all listed by the Center for Responsive Politics as receiving the greatest amount of campaign contributions from the “retired industry.”

³⁰ These are only three of the four Republicans who voted in favour of the Bill (CFRP 2010).

One way of illustrating the economic differentials between those who regulate and those who are regulated is by comparing the salaries of those in the regulatory business with those in the investment business. By this measure of economic resources, those who are regulated are much better paid and appear to have more influence. For example, the chairperson of the SEC, the top position in the agency, was valued at only \$158,500 in salary (in 2007) compared to the CEO of Goldman Sachs, Lloyd Blankfein, who in 2007 received a bonus of \$67.9 million (Barr 2007). Business maintains that large salaries are rewards for superior performance, they keep talented employees from leaving, and the committees that decide compensation for top-level executives often have personal and professional ties to the CEOs.³¹ On top of this disparity in compensation for their top-level employees, profit-generating businesses such as investment banks both generate and manage their operating budgets, whereas regulatory agencies such as the SEC are dependent on budget-approval from Congress. Furthermore, the fines that the SEC collects from violators go directly to the Treasury, not to the agency itself (Johnson 2009; SEC 2010g). Although the SEC has seen its regulatory budget increase over the past ten years, the notable jumps have followed periods of financial crisis, such as the major bankruptcies and accounting scandals of 2001-2002 and the latest 2008 crisis. Whatever its budget difficulties, the SEC received much criticism for its failure to prevent the 2008 financial crisis or stave off the collapse of the subprime mortgage market. Despite this failure to carry out the duties for which it was specifically created to prevent, the SEC received budget increases in the two years following the financial crisis, until the Republicans gained majority in Congress. The change from a Republican to Democrat-

³¹ The board of directors at ENRON was described as having been “in [Kenneth] Lay’s back pocket” resulting in him receiving a salary increase and stock options worth as much as \$90 million which could be cashed in quickly (McLean and Elkind 2003).

run government led to the SEC and President Obama to seek a greater increase in the SEC's budget from Congress. However, following the mid-term elections that saw Republicans seize majority in Congress and attempt cuts to the newly passed Dodd-Frank Act, the SEC's budget increase also came under contestation (Protest and Craig 2011).

As previously stated, political barriers to regulation are greatly connected to the economic influence that the corporations who are the targets of regulation can exert over and through the political system. Furthermore their economic advantages contribute to their mounting technological superiority over regulators. This will be further discussed in the Technological Barriers section; however it is worth noting here that multi-billion dollar investment companies are easily able to fund the latest state-of-the-art equipment to compete in the technological "arms race" whereas regulators with limited budgets struggle to keep up. In the interim, even if the regulator had sufficient financial resources, its employees would still find their hands legally bound by the laws that both bestow and limit their authority. This is the topic pursued in the next section.

Section IV: Legal Barriers

Governments ostensibly pass laws governing the financial industry to protect investors and maintain confidence in the integrity of a nation's financial system (Snider 2009). These acts are meant to protect investors and prevent similar crises in the future, yet on a grander scale they show government dependence on business and the corporate sector. Two important pieces of legislation that have been passed in the United States within the last decade are the Sarbanes Oxley Act 2002 (SOX) and the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (Dodd-Frank Act). Through analysing these two pieces of legislation that attempt to curtail financial misconduct, through exploring how they came to be law and the parties who had the most influence over their

content, I will demonstrate how laws written to grant authority to regulate have actually constrained the regulators' attempts to do so.

To demonstrate this, Friedrichs (1996) draws attention to the regulatory and deregulatory cycles that have occurred in U.S. history. He cites 1900 to 1914 as the Progressive era, when the abuses of big business were first coming to light and thus setting the stage for government intervention into harmful corporate and occupational activities. "In reality, however, much of the regulation developed during this period was supported by, and benefited, the newly regulated big businesses" (Friedrichs 1996: 279). Supporting Friedrichs' argument, Simpson (2002) adds that the regulations passed during this time were "relatively lenient" and some laws, such as the Sherman Antitrust Act, "were directed against 'enemies' of business instead of businesses themselves" (81). Kolko (1963) interpreted the type of regulation and political intervention that occurred at this time as indication of the influence that business had over politics. Regulation, in the form of sweeping legislation, was only passed after a crisis, often rushed through the legislative process. Typically, the legislation is eventually proven to be inadequate for various reasons: it might be too broad, thus allowing for legal loopholes to be found, such as in the example of SOX (Soederberg 2008; McBarnet 2006); it might be too narrow, and thus ties the hands of regulators during a crisis (Steven Adamske in Connelly 2010); it may face excessive lobbying which stagnates the implementation process; or lawyers and accountants may render it ineffective by finding ways to circumvent the regulations (McBarnet 2004, 2006; Snider 2009). Furthermore, once the public spotlight on the financial crisis fades, regulatory agencies are weakened by a lack of "political, social, cultural and economic authority" to adequately or pro-actively enforce the new rules (Snider 2009: 192). All of this occurs against the backdrop of changes to the political

party in power—such as the recent resurgence of Republicans that has caused a re-examination of the Dodd-Frank Act.

Since the turn of the twenty-first century, the financial markets have been afflicted by two significant periods of turmoil. After the burst of the technology bubble, 2001-2002 became landmark years for the revelation of financial scandals and subsequent legislative manoeuvres to avert future crises. Enron and WorldCom are two among of the companies whose chief executives were embroiled in accounting scandals that would eventually lead their corporations, once at the top of their fields, into bankruptcy (O'Brien 2004-2005; Giroux 2008). The years leading up to 2008 laid the groundwork for the next market crash that would strike global markets, the collapse of the subprime mortgage market. 2008 also saw the collapse of major firms; this time in the investment industry (Bear Stearns and Lehman Brothers, among them) whose executives gambled with investors' money and misled investors about the risks of the subprime market (Financial Crisis Inquiry Report 2011). Occurring merely six years after the last major financial crisis, businesses struggled with a significant decrease in investor confidence and governments struggled to revitalize the market by taking steps to ensure to the broader public that stock markets were a safe and fair place to invest.

The most common method for governments to demonstrate that they are addressing an issue is by passing new legislation. Thus each financial crisis has created its own “regulatory legacy” (Haines and Sutton 2003) often in the form of legislation that is promptly passed to reassure the investing public, legislation that is subsequently portrayed as “excessive and ill-conceived” (McKenna 2007) and an “overreaction” (Pasha 2006). During periods of crisis, Snider (2009) contends that the public gives “cultural permission” to regulators to heavily scrutinize the behaviour of powerful actors. She

notes a “window of opportunity” after a period of crisis when “regulators have permission to go after major players, to investigate pro-actively and prosecute” (192). This is often when enforcement is high profile, making it harder for defendants to negotiate plea bargains or deals for reduced sentences. However, the rush to pass new laws often has detrimental effects on regulation. The terms of the legislation are either too broad, which allows business to shape the laws to suit their interests, or too specific, which can tie the hands of regulators in the future. However, broad legislation that has not been carefully vetted through layers of government bureaucracy may contain loopholes. For all these reasons, regulators may find their attempts to use surveillance restrained by legislation that was meant to empower them in the first place.

As noted earlier, the Sarbanes-Oxley Act 2002 came after the major bankruptcies of 2001-2002. Following the slew of financial scandals in those years—particularly Enron and WorldCom—it became evident that the then-current legislation was not doing enough to protect investors from the risk-taking and malfeasance of corporate executives. Thus one of the goals of SOX was to increase the effectiveness of corporate governance through greater transparency. As such, one of the changes it required was for chief executive officers and chief financial officers to certify their company’s financial records therefore making it difficult for them to claim ignorance of fraudulent accounting practices (Meeks 2006). It was a “top down” approach to assigning responsibility cultured by heightened corporate compliance. Another was to require companies to report their internal controls, thereby providing a transparent chain of responsibility. Meeks (2006-2007) argues that transparency is crucial, that one of the reasons why white-collar crime exists is the information gap between investors and regulators on one side and corporations on the other. Corporate disclosure as a tool is not new. It has been included

within securities laws since the Great Depression (Meeks 2006-2007). Benson and Simpson (2009) support that “one of the best ways that regulations can help reduce white-collar crime is increasing transparency, making it harder for potential offenders to deceive consumers and other victims” (194).

The President at the time, George W. Bush, hailed SOX as the most important piece of legislation since the Securities Exchange Act of 1934 (Bumiller 2002; Soederberg 2008). However, shortly after it was enacted, it began to draw much criticism, from even the creators themselves. Michael Oxley, one of the drafters of SOX, admits that he would have done things differently if there had been more lead-in time. In a 2007 *New York Times* article on the former Republican Congressman, Oxley admits that Congress was feeling pressure from the voting public. “Everybody felt like Rome was burning...People felt like they were getting cheated” and then-President George W. Bush was among those pushing for a bill to restore investor confidence. “Frankly, I would have written it differently, and he would have written it differently,” Oxley added, referring to his co-sponsor Senator Paul Sarbanes. “But it was not normal times.” Until then, Congress had been dragging their feet on passing a bill to tighten corporate controls, held back by lobbying by big business (Alderman 2007).

Shortly after the 2008 financial crisis came the next significant piece of legislation regarding financial regulation. The Dodd-Frank Wall Street Reform and Consumer Protection Act brought with it an increased set of powers for regulatory authorities, new stipulations for increased transparency and accountability, created new agencies dedicated to consumer protection and financial oversight, and promised that financial firms deemed “too big to fail” would no longer be the responsibility of the taxpayer to bail out. Despite being signed into law on July 21, 2010, the piece of legislation remains incomplete to this

day. At least 243 financial rules were left up to the regulators to write; the SEC alone is responsible for 95 rules (Morgenson 2010). In the interest of transparency, the regulators (among them, the SEC, the Commodities Futures Trading Commission (CFTC), and the Federal Reserve) solicited comments from the public to inform their rule-making process (SEC 2010i; CFTC 2010; Fed 2010). However, the regulators, more specifically, sought input from those corporations who would be subjected to these rules, the very subjects the rules were meant to reform and govern. The justification for this process was that corporations have the “best” idea of how businesses should be run and demonstrates the government’s unwillingness to interfere too much with free enterprise (Soederberg 2008). At the same time, when it comes to implementing the laws that “regulate” everyday citizens, those who are less privileged than the wealthy businessman, very little input is typically sought by police and legislators. In fact, such laws are often so swiftly implemented, particularly following a moral panic, that it is decades before they are found to be too harsh (as they often later are)(Goode and Ben-Yehuda 1994).

To sum up, the legislation that follows each financial crisis often only finds temporary effectiveness because “corporate lawyers, accountants, consultants and bankers begin devising new ways to shape, stretch and legally circumvent it” (Snider 2009: 180). Today, a new challenge has emerged, forcing the lawmakers and regulators to struggle to keep up with the advanced technology developed by regulatory subjects. This technology, constantly evolving and speeding up, has created a whole new set of challenges for regulatory agencies, as well as a whole new set of barriers to the use of surveillance technology in the field of stock market crimes.

Section V: Technological Barriers

The most common way in which corporate financial crimes can be perpetuated is through trading in the stock market. Because trading has evolved from the outcry trading pits (described in Chapter 3) to computerized trading, computers and algorithms are left to do most of the complex work. This opens up another gap in the regulatory process. As trades are often made in a fraction of a second, the surveillance tools used by regulators, or even the firm's own self-regulatory departments, become more and more ineffective. Given that there is more money to be made in engineering faster tools for these firms and exchanges, than there is in creating better surveillance tools for regulators, agencies such as the SEC find it difficult to keep up. The battle of technology between the regulators and the investment firms they regulate has become a high frequency "arms race" (Gehm 2010). Although agencies such as the SEC have always suffered from technological inferiority, and this has always made the job of policing Wall Street difficult, Wall Street firms today can purchase both the resources and the expertise to elude regulators. By examining the high-speed tools used by various investment firms and stock exchanges, this section will show how rapidly advancing technology serves as a barrier to the deployment of surveillance as a regulatory tool.

The need for regulation was made crystal-clear by the technology-driven trading crash that occurred on May 6, 2010. On that date, Dow Jones plunged approximately 700 points in a matter of minutes. When markets crash, it is often triggered by one event, be it a "fat fingered" trader³² or an unusually large sale or purchase order. In this case, it was a large sale order conducted by a "sell algorithm" (SEC and CFTC 2010). This set off a

³² A tale often told of errors that may occur when a trader placing a trade request into the computer mistakenly presses an incorrect key, sending the markets spiralling into disarray.

domino effect because many buy and sell orders are automated—they use algorithms designed to buy or sell when a price reaches a certain value. Because of this, regulators had no control over market events once a crash has been set off. To address this weakness, the SEC implemented a pilot project by adding circuit breakers to the markets. This ensures that there will be “coordinated market-wide trading halts if a severe market price decline reaches levels that may exhaust market liquidity”³³ (SEC 2010j).

In the days of the trading pits, the trader who could make the fastest trades who was the most successful (Zaloom 2006). When computers were brought in to make trades, some traders “[worked] both the online and pit markets simultaneously” (Zaloom 2006: 161). Zaloom (2006) calls the transition to electronic trading an example of “technological rationalization.” She observes that

“Although social ties create the basis among traders for understanding and analyzing the market, the effort to create spaces, technologies, individuals, and representations that express pure market reason is a key part of the rationalization process” (Zaloom 2006: 162).

Rational or not, high frequency trading (HFT; also called algorithmic trading) has produced an online market where traders use powerful computers to compile market data, find statistical patterns and locate pricing anomalies (Urstadt 2010). During this split second, these HFT programs issue millions of stock orders and just as quickly cancel them, during which time an algorithm is able to “probe for the maximum and minimum price a seller or buyer would accept for any given share” (Snider and Molnar 2010). These programs make trades based on this information, profiting in the amount of a few cents per share from the minute price differences. This quickly accumulates into million-dollar profits when millions of these shares can be traded at once in just microseconds

³³ These thresholds are set to halt price movements of 10%, 20% and 30%, calculated at the beginning of every quarter (SEC 2010j).

(Snider and Molnar 2010). Unfortunately, the investment bankers benefiting from these technologies are always several steps ahead of their regulators in the speed and sophistication of their technological equipment. This comes as no surprise considering that the budget of the regulator comes from government whereas the budget of the investment firms comes from the profits these highly lucrative businesses generate, not to mention the income they have received from both tax breaks and government bailouts (Garnaut and Llewellyn-Smith 2009). Because high frequency trades occur so quickly, investment frauds that are cleverly perpetrated often remain undetected—unless and until the trade is large or anomalous enough to signal an alert, or, worse, causes a market crash (as in the “flash crash” described earlier). As regulators attempt to utilize technology to assist in their investigations, for example through software programs that detect anomalies in trading patterns, firms are constantly and rapidly developing even more sophisticated technologies, essentially to generate greater profits (for them), but also to circumvent new market surveillance technologies.

In a business where time really does mean money, having the fastest, most complex algorithms to process trades can be a competitive advantage to firms that stand to make millions from high-volume trades made in microseconds. Firms buy the equipment and expertise to improve their technology, to increase the speed and decrease the time it takes to make trades in order to profit before another firm’s algorithms can detect and exploit the same patterns in the market. Some firms have even gone so far as to co-locate³⁴ their hardware, that is to physically locate their hardware closer to the exchanges to decrease the amount of time it takes for trade signals to travel to the exchange (Gehm 2010). By physically placing the hardware next to the exchange, firms gain an advantage of the

³⁴ Co-location is on-site computer hosting.

crucial fraction of a second faster that their messages can travel. In addition to complex mathematical algorithms, firms utilize such tools as dark pools and smart routers to gain an advantage. Dark pools are large blocks of shares traded off-market and away from the visibility of the public. They are designed by such investment banks as Morgan Stanley to be “truly dark” in order to prevent information from leaking out. Dark pools allow large blocks of shares to be traded without revealing information about what the price is, or the identity of the company ordering the trade (Morgan Stanley 2010). Smart routers are tools used by such firms as Morgan Stanley and Citigroup Inc. to enhance the speed of the trades. They are “smart” in that they are able to monitor market metrics in real-time, generate feedback from market activity and provide a history search. In addition to that, they analyse “major variables of price, current and historical liquidity, speed, and stability to determine its choice of destination for an order,” all in less than 700 microseconds (Morgan Stanley 2010; Mehta 2010). As a result of these extremely high speeds at which trades are made, every microsecond counts and any trade that is microseconds too slow costs.

The practice of high-frequency trading is not without critics, especially among those who see that with computers trading so fast and with so many funds being traded at once, the potential for a crash is imminent (Donefer 2010). Firstly, the act of co-locating hardware has been criticized by industry observers because it provides an unfair advantage to the larger and wealthier firms because only the biggest and most powerful firms have access to these locations and can afford the fee to store the hardware³⁵. Those who cannot afford the fee are disadvantaged in high-frequency trades. Moreover, some

³⁵ For example, the standard co-location package for the Intercontinental Exchange (ICE) is \$4,000 for installation and a fee of \$3,500 per month (Gehm 2010; ICE website).

argue that this has created a market that benefits whoever moves the fastest when orders should be placed based on a “first in, first out” strategy (Gehm 2010). Secondly, as markets receive millions of orders for trades in seconds, the computers that handle these complex orders face the risk of becoming overwhelmed and crashing, just as any personal computer may do. With the increasing use of algorithmic trading, the speed of trading is becoming increasingly fast. Critics call this trading technique “a variation of front-running, an old (and illegal) practice that involved traders buying and selling in advance of [customer] orders” (Urstadt 2010: 46). Defending their actions, those in the industry reply with the claim that this is not the case since high-frequency trading firms do not have customer orders and therefore cannot front run. Wilmott in Urstadt (2010) further argues the threat of a system of high frequency trading. The increasing dominance and speed of algorithmic trading “could cause tiny price changes to snowball, rolling down the hill at exponentially increasing speeds—either because the machines are trading too fast or because too many funds are trading in the same style.” (Wilmott in Urstadt 2010: 46). This creates the potential for a crash, much like the flash crash that occurred on May 6, 2010.

On the part of the regulators, keeping up with the rapidly advancing speed of trading technology has been a challenge that it has yet been able to accomplish. Yet, it is important that regulators do much more than simply “keep up” with the speed of trading, they need to be able to effectively restrain and sanction illegal trading activity. Gandy (1993) argues that updating technology to give regulators “Ferraris as police cars” assumes a fix that is purely technological (rather than cultural, political, economic and legal, as discussed above. In merely giving regulators the tools to catch up with high speed trading, these factors are overlooked.

Conclusion

The five barriers discussed in this chapter have been presented as overlapping factors that impose limitations on regulation and regulators. The cultural, political and economic barriers demonstrate the close connections that tie government officials and regulators to corporations. These ties, in turn, affect how legislation regarding the regulation of corporations is drafted and how it is later revised and enforced. The economic resources of most corporations, in comparison to the financial resources of regulators, allow investment firms to obtain the tools to evade surveillance, and thus attain, “rights to privacy” that are not available to other potential lawbreakers. This chapter has attempted to demonstrate that corporate crime is a systemic issue with multiple limitations toward regulating it. For this reason, surveillance as a regulatory tool has been underused in this area.

Chapter 5

Conclusion

The purpose of this thesis was to draw attention to an area of crime in which surveillance has been underused. While surveillance literatures have commonly studied the application of CCTV and offender monitoring technologies (Norris 2003; Nellis 2005) for “conventional crimes,” corporate crime is an area in which surveillance has been understudied by scholars. This is largely due to the fact that, as a tool, surveillance is underused by law enforcement agencies to address corporate crimes. This thesis intended to explore why this is.

White-collar crime, as a discipline, has been understudied as well. Although it has existed since the birth of the modern corporation, it was not until Edwin Sutherland gave his infamous speech on white-collar crime that it was given a name. Sutherland asserted that scholars ought to also look at persons of “respectability and high social status” for criminal behaviour, particularly because they are often given “differential treatment” by the law due to their social status (Sutherland 1961:9). What Sutherland noted was that crimes perpetrated by such classes of people, in the course of his or her (Sutherland said “his”) occupation, cost the victims of their crimes far more than the crimes by traditional (“blue-collar”) criminals did. During the seventy years since his speech, the cost of white-collar crime has risen exponentially. In some instances, the result of corporate white-collar crime has caused major financial crises that reverberate into global markets.

This thesis began with a literature review on white-collar crime, looking at the multiple attempts to define it, and examining theories of causality. In this chapter, I discussed the changing attitudes toward corporate crime over time and assessed the

literature on current regulatory controls, both internal and external. The final part of the Literature Review studied the history of surveillance and its current uses. As surveillance is largely used to address conventional crimes, this part of the thesis served to provide background information in order to assess the potential for the use of surveillance in corporate crimes.

In the first part of Chapter 3 I looked closely at two major law enforcement agencies in the United States who contend with corporate crimes, the SEC and the FBI. In this chapter I examined both their processes of enforcement and what enforcement powers they have. In the second part of this chapter I investigated three examples of the use of surveillance by law enforcement agencies, providing a comparison of the enforcement powers that they *use* versus what I had earlier revealed them to *have*. In the first example, the SEC required the NYSE to implement a pilot program for an audio and video surveillance system on its trading floor, following the discovery of abusive trading practices by several of their specialists. In the second example, the new Market Abuse Unit of the SEC, created for the specific purpose of using computer surveillance techniques to detect market abuses, is examined. The third example demonstrates the latest “crackdown” on corporate crime as FBI agents have, for the first time, used wiretapping in investigations into insider trading. A significant point of this chapter is that the three examples that I gave were the *only* three instances of the employment of surveillance that I could find in my research; exceptions to the arguments that I have established that electronic surveillance is seldom used to address corporate crime. This is indicative of the dire state of corporate crime enforcement as surveillance has been touted by many as an effective crime detection and prevention tool.

Chapter 4 identified five barriers to the use of surveillance to address corporate crime. In the first section, I described how a corporate culture of competition and success, promoting risk-taking and profits-at-all-costs has rendered surveillance less effective because the incentives to succeed far outweigh any deterrence produced by surveillance. In the second section, I identified political barriers that exist to surveillance, and more generally to regulation, as a revolving door that operates between the major institutions involved in this discourse: the corporation, the government, and the regulatory agencies. These ties have led top corporate executives into key decision-making positions within the government, making decisions on regulations that affect the very corporations they used to lead. This has subsequently had real impact on legislation. Additionally, this revolving door has led many regulatory employees into better paying corporate positions, bringing with them important insider knowledge of regulatory operations. The third section of this chapter discusses the economic barriers to surveillance, arguing that those in government who oppose certain regulation have been financially supported through campaign contributions by corporations with a vested interest in seeing particular laws passed or defeated. This section also discussed the implications of the fact that corporations have greater resources than the regulators and subsequently can pay their employees higher salaries, and operate with greater budgets. In the fourth section, I examined legal barriers to regulation/surveillance that have either limited regulators' ability to regulate businesses or have perpetuated a system in which those who are regulated have input into their own regulation. That is, governments often ask the regulators to write the rules for particular pieces of legislation, and the regulators then turn around and ask for input from the very corporations they are supposed to regulate. Finally, the last section examined the technological barriers, which are the most tangible

of the five. As technology used by firms becomes increasingly faster and more complex, particularly in the area of stock market surveillance, regulators struggle to catch up. Moreover regulators lack the resources to employ experts and purchase equipment that can effectively monitor for abusive practices.

With these five barriers in place, it is not surprising that surveillance has only been employed in the three cases described. I have been careful to stress that these five barriers are not separate; they work concurrently with each other to create and reinforce corporate privilege. As such, it is difficult to place blame on a single individual (one “rotten apple”), a single factor, or a single corporation for financial scandals and subsequent crises, given that the entire system, from the government actions to the regulatory tools to the way the corporations themselves behave, is flawed. Since the damages done by corporate crimes impact greater numbers of people and cost millions, even billions of dollars more than “traditional” crimes such as theft, this area of study requires further research. Surveillance, touted as an important tool for law enforcement, continues to be infrequently employed in the realm of corporate policing. However, the case of Raj Rajaratnam (discussed in Chapter 3), the first use of wiretapping to detect insider trading, indicates that a change could be on the horizon. This case has already prompted investigators to employ wiretaps in another investigation into an insider trading ring (Wyatt 2010) and has even impelled the UK to implement a more aggressive surveillance system by requiring financial firms to record the cellular phone conversations of their employees (Chung 2010). With the increased publicity given to corporate scandals in recent years, corporate crime is beginning to come to the forefront of the public’s attention. This newfound exposure has the potential that optimists hope will lead

governments toward more effective regulation, regulators toward more pro-active roles, and corporations toward greater responsibility and accountability.

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