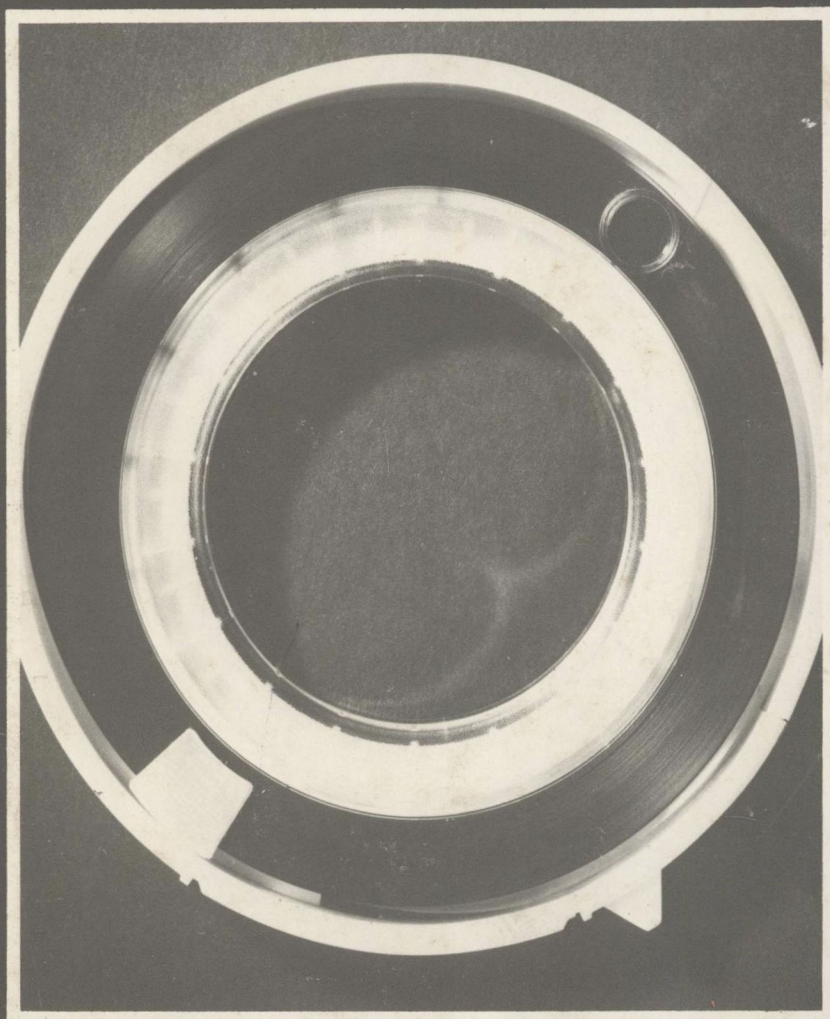


# Controlling Unlawful Organizational Behavior

Diane  
Vaughan

*Social Structure and Corporate Misconduct*



Controlling Unlawful  
Organizational Behavior  
*Social Structure and  
Corporate Misconduct*

Diane Vaughan

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# Controlling Unlawful Organizational Behavior

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To my parents and my children

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# Introduction

Picture a room filled with grey metal desks. At each desk sits a welfare department social worker interviewing clients. An elderly woman with a shopping bag sits with others on a bench along the wall waiting her turn. At a nod from her social worker, she goes to the wooden chair beside the desk, rummages through her purse for some papers, then empties the contents of the shopping bag on the desk. Prescription medication bottles spill out. For the next forty minutes the welfare recipient and the social worker sort through the bottles, comparing the prescription numbers on each bottle with a list of prescription numbers on a letter sent to the woman by the welfare department. The purpose of the letter is to verify that she did, in fact, receive the goods the pharmacy records indicate she received.

This scene typifies the sweeping changes in health care delivery in this country. For large segments of the population—the blind, the poor, the aged, and the dependent—obtaining goods and services related to health is no longer an exchange between the seeker and provider of services; the encounter has now expanded to include the government, which formulates the rules for the exchange. Nursing homes, pharmacies, hospitals, dentists, physicians, and ambulance services sign contracts with federal, state, or local government program sponsoring agencies to deliver their specialized goods and services to the public. These providers are then reimbursed in accordance with established guidelines and regulations.

The entire system is built upon a network of increasingly specific and intricate rules—rules which affect whole classes of individuals and organizations. Providers as well as recipients must meet eligibility requirements to participate, the government must

distinguish between those goods and services for which reimbursement will and those for which it will not be allowed, providers must adopt procedures for seeking reimbursement that conform to federal guidelines, federal agencies require reports of state and local programs, which in turn require filing by providers, caseworkers, recipients—and on and on. The rules are directed at standardization and control. Yet not only has standardization not been achieved, but attempts to impose order have spawned disorder. Benefit programs are accused of excessive red tape, burdensome paperwork, inadequate verification of data, and poor quality control.<sup>1</sup> Significantly, these administrative weaknesses have created what insiders call “program vulnerability”: they present multiple opportunities within the benefit programs for individuals, groups, or organizations to take unintended or illegal advantage of the system.<sup>2</sup>

And take advantage they have. Fraud and abuse of government benefit programs are widespread.<sup>3</sup> To combat the losses, federal, state, and local governments have committed substantial audit, investigation, and computer resources to detection. On 28 July 1977, for example, Revco Drug Stores, Inc., one of the nation’s largest retail drug chains and a Medicaid provider, was found guilty of a computer-generated double-billing scheme that resulted in the loss of over a half million dollars in Medicaid funds to the Ohio Department of Public Welfare. The case is unique, yet indicative of a serious and changing trend in the nature of unlawful behavior in our society. Where once both offender and victim were individuals, in this instance both roles were played by complex organizations, and the definition of who was offender and who was victim was not so clear. Further, the intricacies of the Revco case were deepened by the use of computer technology, both in the commission and the investigation of the unlawful conduct. The complexities were such that were it not for a serendipitous series of events, the offense would not have been discovered at all. Moreover, the impenetrability of both the offense and the offender necessitated the involvement of not just one but five investigative agencies in the discovery, investigation, and prosecution of this case. In the absence of any single formal mechanism to deal with this type of misconduct, these five organizations pooled their specialized skills and resources, forming a social control network to pursue the wayward corporation.

The details of the Revco case and investigation tantalize the sociologist, for this event indicates significant social change: change in the nature of crime—and in the way society organizes to combat it. Unlawful behavior by organizations is a natural consequence of the transformation of social structure. Not only do individuals interact with individuals; now they interact with organizations, and organizations interact with other organizations.<sup>4</sup> These new sets of relationships have affected opportunities for unlawful behavior. The roles of victim and offender are no longer restricted to individuals. Organizations can and do assume either role, and frequently—as in the Revco case—both. The parallel development is the emergence and growth of regulatory agencies, such as the FTC and SEC, directed toward controlling organizational misconduct. This occurrence has been so widespread that the monitoring and regulation of corporate interactions has itself become “big business,” with the complexity of the regulatory agency at times matching or even exceeding that of the organizations it regulates. The Revco investigation stimulated my curiosity about these developments. The result is this book, which addresses two major questions: (1) how, in this case, did society organize to combat the unlawful behavior of an organization, and (2) in what ways is society organized that may encourage the very phenomenon it purports to restrain?

The pages that follow are shaped by three strongly held personal beliefs. First, the behavior of organizations should be understood within the context of the social structure in which it occurs. Thus, I examine the Revco case within the immediate social structure, delineated for research purposes by the interaction of the organizations that participated in the event, and then I examine the broader structure of American society for factors relevant to the origin and control of organizational misconduct. Second, given the rise of regulatory agencies to control corporate conduct over the last several decades, merging conceptual tools and knowledge of interorganizational relations with what is known about organizational misconduct is a logical and fruitful step. To date, however, there has been a clear, if unarticulated, division of labor among sociologists. The interaction of organizations has been primarily the realm of those with expertise in complex organizations; the unlawful behavior of organizations has been the subject of research by those interested in deviance and social control.

This book is couched in a framework that merges these two sub-disciplines of sociology.

Third, field research that reveals the little-understood intricacies of these interorganizational relationships is the most appropriate research style. Consequently, the data were gathered in what amounted to five case studies, one conducted in each of the social control agencies that investigated the case. The information was obtained through interviews with members of the agencies, lawyers, legislators, financial analysts, stockbrokers, and reporters. These interview data were supplemented by materials in agency files, government reports, newspaper articles, interorganizational memos, and official documents related to the case.

My original hope for this research was that I could develop an analysis of the case that included both sides of the story. Not that there existed some objective truth that could be uncovered by blending or comparison, but that for Revco and for those doing the investigating there were separate realities: a truth for each side. The best I could do was to portray as holistic a representation of what happened as possible by presenting each of these realities. Unfortunately, because Revco did not participate in the research, this book is based on only one. Yet how the network organizations went about their work is relevant, documented, and worthy of inquiry and attention. This is so, regardless of that "other side of the story" that has remained elusive.

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# The History of the Case

## A SERENDIPITOUS DISCOVERY May 1976

An alert pharmacist in an Ohio Revco Drug Store noticed that a neighborhood podiatrist had been prescribing large quantities of narcotics and tranquilizers—medications that appeared to be outside the scope of podiatry practice. Alarmed, the pharmacist called the Ohio State Board of Pharmacy. The pharmacy board quietly initiated an investigation.<sup>1</sup>

July 1976

A vice-president from Revco headquarters called the pharmacy board to encourage pursuit of the inquiry. He suggested a thorough examination of all the records of the Revco store most frequently used by the podiatrist. The pharmacy board got in touch with the Ohio Department of Public Welfare. Among the vast amounts of data stored on welfare department computer tapes were the prescription records of the targeted Revco store. As one of the state's largest Medicaid providers, Revco routinely sent records of all prescriptions filled for Medicaid recipients from its 159 pharmacies scattered around the state to corporate headquarters in Cleveland. There they were entered on tape and submitted to the welfare department as claims for reimbursement. The welfare department agreed to assist the pharmacy board by generating the computerized claims records for all Medicaid prescriptions written by the podiatrist and filled in the pinpointed store.

August 1976

Manual examination of the computer output began. An experienced analyst in the investigative unit of the welfare department, the Bureau of Surveillance and Utilization Review (SUR), further decomposed the data by hand, taking weeks to chronicle the prescription histories of forty-five patients of the podiatrist. This painstaking work exposed an irregularity. The prescription numbers did not flow in the usual ascending numerical order. Instead, lower prescription numbers occasionally occurred within a sequence of ascending numbers. Closer examination revealed that the last three digits of certain six-digit prescription numbers were being transposed. A pattern appeared. A prescription was recorded as a claim and three days later the identical prescription was recorded again with the last three digits transposed. This same pattern appeared in the hand-detailed report of each of the forty-five patients.

October 1976

To clarify whether the transposed prescription numbers were linked to the podiatrist's prescribing practice or to the Revco store, the pharmacy board and the welfare department's SUR agreed to expand the investigation. Computer-generated claims histories were ordered for twelve additional Revco stores in the same metropolitan area. Months passed as several SUR analysts examined the data manually. Transposed prescription numbers were found in each of the stores' computerized records, regardless of prescribing physician.

March 1977

A meeting was held between the welfare department's SUR and the pharmacy board to discuss possible explanations. The transposed prescription numbers could have been the result of a welfare computer mistake. To check this, claims histories were ordered for a different drug chain, in order to compare Revco's records with those of a competitor. There was a second possibility. The numbers could have been intentionally transposed by Revco. SUR and the pharmacy board suspected that certain prescriptions had been the basis of false billing to the welfare department, submitted for payment a second time with numbers transposed

and dates changed. To test this alternative explanation, computer records of prescriptions with the transposed numbers would have to be verified against original prescriptions held in individual pharmacies. If the suspicious prescription numbers were indeed false, no matching originals would be found. If the suspicious prescriptions were authentic, the search would reveal originals that matched the computer printout in every detail.

This task had to be pursued without arousing suspicion. A mechanism existed that would accomplish it discreetly. The pharmacy board routinely sent investigators into licensed drug dispensing facilities around the state to examine records. A Revco store in a remote area of the state was chosen. An investigator who was familiar with it and whom the pharmacists knew personally was sent to do the job. Lists were prepared of sets of the suspect prescriptions. Each set consisted of a claim for a prescription with a specified number, and a claim for a second prescription identical to the first except for the transposed number and later date.

23 March 1977

Under the guise of a routine examination, the investigator visited the store. For the first prescription number in the set, he found a matching original. For the second, no matching original was found. The original that had the prescription number corresponding to the second number in the set bore a different patient name, drug type, and cost than those on the computer printout. The second prescription in each set was false. Revco apparently had been submitting the same prescription, with numbers transposed, for reimbursement a second time. The Ohio Department of Public Welfare had been reimbursing Revco for prescription claims through the Medicaid program. The question of whether a single podiatrist was practicing outside his area of specialization had led to the far wider possibility of Medicaid fraud by Revco, one of the largest drug retailers in the country, operating 825 stores in twenty-one states.<sup>2</sup> Revco had 159 stores in Ohio. How many of these stores were involved had yet to be determined.

The pharmacy board considered two possibilities: the false prescriptions could be the result of a conspiracy among several of the individual pharmacies—or they could have originated centrally, in the upper echelon of the corporate structure, thus af-

fecting every Revco store in the state. The board cast aside the notion of a conspiracy among employees at the store level, believing that the similarity of method across stores would have been unmanageable because of the numbers of people who would have to have been involved. Instead, the board concluded that the suspected fraud appeared to be a centrally originating computer crime, possibly statewide, conceived and carried out by a handful of people. Deciding that the case was bigger than it was prepared to handle, the board asked the Ohio State Highway Patrol to join the investigation because of its previous experience with welfare fraud cases and its statewide jurisdiction to investigate any criminal act involving state property interests.<sup>3</sup>

The next stage would be a delicate one. Every possible step must be taken to maintain secrecy, for Revco's awareness of the ongoing investigation might precipitate destruction of evidence. Further, the evidence must be secured in a manner that would both establish fraud and prevent any procedural errors that would provide Revco a loophole. On 11 April 1977, these contingencies led the highway patrol to ask the Economic Crime Unit of the Franklin County Prosecutor's Office—the county in which all welfare billing for the state originates—to enter the case. This unit assumed direction of the rest of the investigation, using its legal expertise to assure that no loopholes would occur.<sup>4</sup>

#### OBTAINING THE EVIDENCE

In order to charge Revco with fraud, the Economic Crime Unit needed sufficient evidence to establish probable cause. To do this, the unit had to prove that the corporation had been reimbursed by the welfare department for the false prescriptions, and to establish intent. First, the reimbursement problem. The computerized records of claims Revco had submitted to the welfare departments were examined. Fifteen sets of claims containing fifteen suspected fraudulent billings were traced and carefully compared with remittance statements and checks sent to Revco by the welfare department. The corporation had indeed received payment on each of the billings traced.<sup>5</sup>

Intent could be demonstrated by showing that the false prescriptions were in sufficient number to indicate that they had been generated knowingly and not as a result of negligence or mistake. The welfare department's Division of Data Services developed