WHAT CONSTITUTES TOO-BIG-TO-JAIL?: Evidence From South Korea

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WHAT CONSTITUTES TOO-BIG-TO-JAIL?

Abstract

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This paper investigates the judicial bias in favor of chaebols. The Korean judiciary favors chaebols (powerful family business groups), as convicted chaebol-related defendants receive on average 9.9% more jail-sentence suspensions and 19 month shorter jail terms than non-chaebol counterparts do. The leniency remains robust after controlling for the quality of defense attorneys and other sentencing factors. We hypothesize that this bias occurs because, (1) the judiciary worries that strict sentences against chaebol defendants may cause systemic risk; and (2) the court follows the civil law tradition of being generous to in-group transactions. The results support both hypotheses. The judiciary is generous for the highly leveraged and better performed firms. Controlling for the in-group transactions explains much of the bias. With great victories in courts, chaebol-related offenders justify their wrongdoings, arguing that illegal in-group transactions are in the interest of entire business group, not for their private gain.

Keywords: Law and Finance, Business Group, White-Collar Crime, Tunneling, Civil Law, Self-Dealing

JEL Classification: G34, K14, K42,

INTRODUCTION

This paper examines a judicial bias in favor of chaebols, large family-controlled business groups ('too-big-to-jail') and its sources with quantitative and qualitative studies on the sentencing for 252 high-profile, convicted corporate offenders in Korea. Business groups are prevalent in emerging markets and even in some developed economies (Morck 2007; Colpan, Hikino, and Lincoln 2010). Masulis et al. (2011) document that 19 percent of listed firms belong to family business groups on average around the world, up to over 40 percent especially in some emerging markets. This suggests that the understanding of business groups is key to a study on comparative corporate governance.

Korea offers an ideal environment for this study. Several episodes in Korea suggest judicial leniency favoring corporate offenders, especially ones tied to powerful family business groups (chaebols); unique details about sentencing decisions are available; substantial heterogeneities exist in the social and economic power of firms.

A prime example is Lee, Gun-Hee, the chairman of Samsung Group, the largest chaebol in Korea. In April 2008, Mr. Lee resigned his post after being charged with tax evasion and breach of fiduciary duty. The Korean judiciary, in August 2009, gave him a very lenient sentence, a three-year suspended jail sentence. By Christmas of that year, President Lee Myung-Bak pardoned him, clearing the way for his return to his former post in March 2010. Hence, a tycoon convicted of multiple felonies returned to power in less than two years.

As another example, consider Jeong, Mong-Goo, the chairman of Hyundai Motor Group (owner of Kia, the country's second-largest carmaker). In 2006, he faced criminal charges of embezzlement and illegal self-dealing. A lower court sentenced him three years in prison, but the appellate court, giving weight to his contribution to the national economy, suspended the sentence and instead demanded $1 billion donation to charity. In August 2008, he too was pardoned.

In the above two episodes, the courts were reluctant to punish harshly offenders whose companies are "too-big-to-jail." Moreover, in our data, the larger the firm, or business group connected to a defendant, the more the judicial leniency. As the *Financial Times* put it, "[I]f Jeffrey Skilling, the former Enron chief executive, was South Korean, you could imagine him

back at his desk, making key decisions." Media often argues that this judicial bias contributes to the Korea discount, the undervaluing of Korean stocks by foreign investors.[1]

In addition, the corporate crime cases illustrate how a civil law system addresses outlawed self-dealing, especially in a business group, benefiting controlling shareholders. Related-party transactions can expropriate minority shareholders for the benefit of controlling shareholders especially in countries where business groups are prevalent (e.g., Khanna and Palepu 2000; Morck 2007). The regulation of self-dealing transactions varies substantially across legal systems, but civil law is generally less protective of outside investors and minority shareholders (e.g., López de Silanes et al. 1999; López de Silanes et al. 2000; Djankov et al. 2008). We analyze such cases.

Few investigate public enforcement, especially the role of criminal courts in constraining self-dealing although existing studies focus on private enforcement, such as legal arrangements and civil litigation, against self-dealing. This lacuna is mainly due to the lack of credible data (Djankov et al. 2008). Such data is available and rich in Korea, especially after the Asian 1997 financial crisis, when prosecutors vigorously brought self-dealing cases to the courts, producing more than 250 convictions. Filling the research gap, we analyze how Korean criminal courts, a civil law jurisdiction, perceive and discipline related-party transactions for controlling shareholders. To our knowledge, this paper is the first systematic research on how civil law systems address self-dealing in its criminal courts.

Our dataset is unique. Using news articles, court decisions, and electronic legal resources, we construct a dataset of sentencing outcomes for 252 convicted corporate offenders, most of whom committed outlawed self-dealing. The cases include large-scale corporate scandals of Samsung, Hyundai Motor Company, and SK Group. All crimes occurred between 1993 and 2006 and were adjudicated between 2000 and 2007.

We find that the Korean judiciary exhibits a strong bias towards chaebols (henceforth, the "chaebol bias"). Chaebol-connected defendants are 9.9%p less likely to be imprisoned than other white-collar criminals. The former are 26.6%p less likely to be held in pre-trial custody than the latter. In addition, the former serve 19-month shorter prison terms even if they are held in jail.

[1] Oliver, Christian."The Korea discount: blame the businessmen." *Christian Oliver*: *beyondbrics*. Financial Times, 31August 2010. Web. 22 April 2014.

This preferential treatment for chaebols remains robust after controlling for various measures for the quality of legal representation.

In addition, we find that chaebols tend to undertake in-group transactions more than non-chaebols. In particular, the more the controlling shareholders hold stake in a troubled affiliate in a chaebol, the more the in-group transactions for that affiliate. This indicates that the in-group transactions are also motivated for private gain of controllers, a stereotypical breach of duty of loyalty in civil law systems (Bae, Kang, and Lee, 2002; Baek, Kang, and Kim, 2006). Therefore, the chaebol-related defendants in our samples would be subject to stricter legal sanctions if they were prosecuted in a common law system.

Our findings are novel and contribute to the existing literature. First, we analyze actual self-dealings in criminal courts and the efficiency of civil law courts as an external governance mechanism. Many law and finance studies argue that legal systems importantly determine ownership structures and financial markets (La Porta et al., 1997, 1998, 1999, 2004, 2006 "LLSV"; Demirgüç-Kunt and Maksimovic 1998; Rajan and Zingales 1998; Wurgler, 2000; Beck, Demirgüç-Kunt and Levine 2003, Mclean et al., 2012).

Our research also explores the interaction between law and finance. We show how the Korean criminal courts address cases involving the expropriation of minority shareholders and function as external governance mechanisms. In this sense, we extend Johnson et al. (2000b), and Djankov et al. (2008). Whereas their main examples involve civil procedures, our work addresses criminal procedures. While their work depends on anecdotal evidence or hypothetical self-dealing cases, we analyze the judicial adjudications on actual self-dealings.

Moreover, while existing literature highlights legal tunneling, we focus on outlawed tunneling. Therefore, we highlight the specific role of criminal courts in limiting unlawful self-dealing and suggest why civil-law criminal courts are lenient when a controlling shareholder expropriates minority shareholders. This is broadly in line with Defond and Hung (2004) suggesting that law enforcement can be more important than investor protection laws in enhancing corporate governance analyzing the relationship between CEO turnover and stock returns.

This paper is related to Choi et al. (2016) that report empirical evidences for judicial bias in favor of chaebols. This paper extends Choi et al. (2016) in three dimensions. First, the main results of Choi et al. (2016) are robust after considering the quality of legal assistance. Second, we take into accounts the financial characteristics of firms to find where chaebol effects come from. Third, we explore what drives the 'too-big-to-jail phenomena' using sentencing opinions for white-collar offenders.

Second, our work offers a plausible answer to the puzzle raised by Djankov et al. (2008) as to why public enforcement is unrelated to stock market developments. They conjecture that the measure of public enforcement, the severity of punishment prescribed by rules, does not capture actual law enforcement. Our work confirms their conjecture. It is the actual judicial actions that matter in the regulation of self-dealing, not nominal statutes on the books. Without identifying actual judicial stance as demonstrated in this paper, it is hard to explain the recurrence of corporate scandals in emerging markets where nominal statutes state that self-dealing transactions are unlawful and severely penalized.

Third, our work contributes to the literature on sentencing outcomes for white collar crimes. Focusing on the sentencing disparities among white-collar offenders, we investigate social power structures such as the disparities between a controlling shareholder and top management or between chaebol and non-chaebol offenders. This extends the recent studies on the disparities between white-collar criminals and other types of offenders. These studies tend to analyze and identify offender demographics, e.g., race/ethnicity and class (Hagan et al., 1980; Schanzenbach and Yaeger 2006), whereas we analyze the characteristics of *offender-tied organizations*.

Additionally, we make methodological contributions. In Posner and Yoon (2010), the recognizable disparities in the quality of legal representation affect 20-40% of criminal cases. Establishing reliable measures on such quality, we can control for the impact of legal representation on sentences. Such control clarifies the extent of sentencing disparities resulting from socioeconomic status.

Fourth, we add an explanation on why investor protection is weaker in civil law countries. LLSV (La Porta et al., 1997, 1998, 1999, 2004, 2006) notes the history of legal systems to explain investor protection. Civil law tradition more allowed state power to restrict property

rights after the French Revolution. Common law tradition became established while protecting the interest of aristocrats and merchants against state powers. In complementing such views, we argue that underlying economic relations can significantly moderate the relationship. We demonstrate how the power of economic organizations can shape judicial decisions in a civil law country and influence the extent of investor protection.

HYPOTHESES

What drives the judicial bias in favor of chaebols? We develop and examine two testable hypotheses: systemic risk hypothesis and civil law hypothesis.

Systemic Risk Hypothesis

The first hypothesis is that when defendants are affiliated with powerful economic organizations, criminal sanctions against them become lighter ('Systemic Risk Hypothesis'). This is a direct extension of too-big-to fail that systematically important financial institutions receive bailouts (Mishkin et al, 2006). Too-big-to-fail institutions are mostly large and interconnected. Their failure can lead to abrupt or disorderly break down of financial and economic system. Similarly, a judiciary can issue favorable rulings for the top managers in economically significant organizations in order to prevent disorderly failure and instability.

Table 1 compares 'too-big-to-fail' with 'too-big-to-jail' and explains why too-big-to-jail hypothesis is valid, how it generates favorable judicial rulings and how it in turn strengthens the structure of business groups. As a result, too-big-to-jail is a 'judicial bailout', may be well-intended in the short run, but can be problematic in the long run. Such judicial intervention can lead to weak market discipline, social injustice and instability in the system that the judiciary intends to protect in the beginning. In sum, the size hypothesis is as follows:

> *Systemic Risk Hypothesis: The more powerful the economic organizations to which a defendant is affiliated, the lighter the criminal sanctions to the defendant.*

The systemic risk might come from simply the size of family business groups or an individual firm. The recent leniency given to Wall Street executives also illustrates this size hypothesis. The U.S. Attorney General Eric Holder told the Senate Judiciary Committee (March 2013) as:

> "I am concerned that the size of some of these institutions becomes so large that it does become difficult to prosecute them, […] When we are hit with indications that if you do prosecute, if you do bring a criminal charge it will have a negative impact on the national economy, perhaps world economy, that is a function of the fact that some of these institutions have become too large."

> In a different angle, the judicial bias exists because of the systemic risk the chaebol imposes on the financial market. We would test the portion of the 'chaebol effect' that comes from how important or central the firm is to the financial market as a whole. These firm level effects capture of the prominence of the firm and its effect on market stability.

Civil Law Hypothesis

Our second hypothesis is the "civil law hypothesis," that too-big-to-jail is more likely to occur in civil law countries. Our logic is as follows. First, the judges in civil law countries can be reluctant to limit self-dealing and so produce the observed leniency. Common law countries with long standing legal principles on fiduciary duty are more critical of self-dealings than civil law countries are (La Porta et al., 1997, 1998; Djakov et al.2008). Common law traditions apply law in a flexible manner. Judges determine which precedents to apply and therefore shape law by leaving their cases as precedents. A jury determines the fact of its case. To Weber (1978: 890), "*English legal thought is essentially an empirical art. Precedent still fully retains its old significance.*"

However, in civil law traditions, judges establish the facts of the case and then apply the provisions of befitting codes. Therefore, unless legal codes are continuously updated in a civil law country, loopholes will arise due to complex dealings inside of business groups in limiting self-dealing. History matters too; civil law and common law traditions had historically emerged as the former highlighted the rights of aristocrats and merchants, while the latter stressed the role of states in controlling property rights (See LLSV).

Second, such self-dealing is more likely to occur in large business groups with many subsidiaries (e.g. Khanna and Palepu 2000; Morck 2007). Firstly, the larger is the number of subsidiaries, the more the opportunities for self-dealing. For example, a business group can

arrange related-party transactions in order to subsidize an affiliate. Secondly, a business group can *pretend* that they perform self-dealing or in-group transaction in order to enhance the interest of the entire business group, but not to seek the private interest of defendants or any powerful stakeholder.

Then, combining the first and second arguments above, we derive the civil law hypothesis. Our civil law hypothesis is consistent with the well-known tendency of civil-law courts to allow substantial expropriation of minority shareholders: *"...in civil law countries, the expropriation of minority shareholders by the controlling shareholder in a transaction with a plausible business purpose is often seen as consistent with director's duties, especially if the controlling shareholder is another firm in the group*." (Johnson et al. 2000b, p 26).

Civil Law Hypothesis: Civil law tradition results in the too-big-to-jail bias on in-group transactions.

HISTORICAL AND INSTITUTIONAL BACKGROUND

Chaebols

Chaebols are dominant in the Korean economy and society (Amsden 1992, Haggard et al. 2003). See Table 2. The total sales and assets of the top 30 chaebols continue to grow. In 1980, the total sale of the top 30 accounts for 60.6% of GDP; in 2011, that increases to 96.7%. From 1980 to 2011, the total asset/GDP ratio has risen from 52.9% to 124.5%.

Chaebols are family owned. Corporate governance differs between firms with and without controlling shareholders (Bertrand and Schoar 2006, Bennedsen, Pérez-González, and Wolfenzon 2010). For the former, the primary governance issue is tunneling where powerful insiders expropriate minority shareholders for its private gain (López de Silanes et al. 2000). Family firms adopt control-enhancing mechanisms such as pyramids and cross-holdings (López de Silanes et al., 1999; Claessens et al., 2000; Faccio and Lang, 2002). These mechanisms separate cash flow rights from control rights, enabling a handful of family members to make key decisions and to govern major corporate sectors in a country (López de Silanes et al., 1999; Claessens et al. 2000; Morck, Wolfenzon, and Yeung, 2004). In chaebols, a dominant shareholder becomes the chairman or president of a business group; a professional top manager is the CEO or director of

an affiliate in the group. Whatever name he has, the dominant shareholder makes the critical decisions of the affiliates.

Before the 1997 Asian financial crisis, outside directors never sat on a company's board; hostile takeovers were practically impossible in Korea. With the absence of such internal and external discipline mechanisms, controlling shareholders could exercise absolute power and reap private benefits at the expense of minority shareholders.

Even after the crisis, chaebols have extended their influence. They appoint politically connected directors (Solidarity for Economic Reform 2009); establish charity foundations for social influence (Solidarity for Economic Reform 2010); set up think tanks disseminating business-friendly ideologies. Some satirize the almighty power of chaebols as follows: "[i]t has become possible to live a Samsung-only life: You can use a Samsung credit card to buy a Samsung TV for the living room of your Samsung-made apartment on which you'll watch the Samsung-owned pro-baseball team."[2]An interesting question would be whether the power of chaebols influences judiciary decisions? We analyze this problem.

Judiciary Selection Process in Korea

It is important to understand the judiciary selection procedure to measure the quality of defense attorneys in Korea. Those who want to pursue judicial careers must pass an entrance exam (the National Judicial Examination). Over the last two decades, less than 1 out 20 (4.3%) applicants pass the exam. Thus, the exam is very competitive and regarded as the path to success and fame. Successful candidates receive two years of training at the Judicial Research and Training Institute (JRTI), a special education institution. Once they complete their training, candidates with the highest grades choose the available position they desire. The candidates with the highest grades tend to pursue judicial careers. Approximately the top 30% of the candidates serve in the judiciary or as public prosecutors. Judges are generally selected from the group of best performers, and prosecutors are from the next best performers. The rest of the candidates start their careers in private law firms or private companies.

[2]Harlan, Chico "In South Korea, the Republic of Samsung."*The Washington Post* December 9, 2012; Print.

The Korean judiciary features civil law jurisdictions in which the Supreme Court appoints judges from the young candidates in JRTI, rotating them through a variety of posts.[3] No judges, even the Supreme Court justices, are appointed for life and none are elected. A newly appointed judge usually needs 15 years of experience to become a senior judge of each judicial panel in a district court (*ibubbujangpansa*). It requires another 10 years to become a senior judge of a panel in a high court (*gobubbujangpansa*).[4] For the judicial and prosecutorial structures in Korea, see Table 3.

Most junior judges become district court senior judges eventually. Their career-mobility prospects, however, diminish significantly as senior judges get closer to the upper posts of the bureaucratic ladder. High-profile judges, especially senior judges, tend to leave the office prior to their retirement if they are not promoted. Such early retirement is very common in the Korean judiciary. Since 1990, only 20 judges (for prosecutors, only 5) remained to retirement age. This accounts for 1.3% (0.7%) of 1519 (1353) retired judges (prosecutors) during the same period. After resignation, retired judges and prosecutors begin private practice.[5] They mostly work in law firms, often as criminal defense attorneys, after retirement. Taken overall, the judicial careers of a defense counsel (including those of public prosecutors) indicate talents and skills. This allows us to develop several proxies related to the quality of defense attorneys.

[3]We highlight selection procedures of the judiciary here. However, recruiting procedures of a public prosecutor are similar to those of the judiciary. All prosecutors are appointed by an attorney general, a political appointee by a president. Unlike in the U.S.A., where the vast majority of prosecutors are either elected officials (local and state levels) or nonpartisan civil servants (federal level), no prosecutor in Korea is elected. Thus most prosecutors leave office and serve as an attorney at private law firms when they fail to get promoted.

[4]For prosecutors, it takes about 15 years for newly appointed prosecutors to get promoted to senior prosecutors, and additional 10 years to be elevated to higher positions than senior prosecutors.

[5]The data were found at the following news coverage
http://www.mt.co.kr/view/mtview.php?type=1&no=2011100511448281559&outlink=1

DATA DESCRIPTION

Definition of White-Collar Crimes

The white-collar crimes in our sample are embezzlement and breach of fiduciary duty in the Korean criminal code (article 356), roughly equivalent to 18 U.S.C. §1341 (Frauds and Swindles) or 18 U.S.C. §1343 (Fraud by wire, radio, or television). Our sample includes bank and accounting fraud cases only when the fraud occurs together with embezzlement and the breach of fiduciary duty.

The offences analyzed in this paper are tunneling (Johnson et al. 2000) and are further divided into four sub-groups: (1) outright theft of corporate assets by a controlling shareholder (“embezzlement’’), (2) self-dealing benefiting controlling shareholders directly (“narrowly defined self-dealing transactions”), (3) related party transactions propping up other affiliated firms within a business group (“in-group transactions”), and (4) accounting fraud.

The key difference between “narrowly defined self-dealing transactions” and “in-group transactions” exists in the specific form of transactions in question. For “narrowly defined self-dealing transactions”, a controlling shareholder is a direct beneficiary of self-dealing. “In-group transactions” occur between a parent company and its subsidiary (or between subsidiaries) indirectly benefiting controlling shareholders.

> “Narrowly defined self-dealing transactions” happen 1) when controlling shareholders sell goods or services to their company at inflated prices, 2) when a firm sells goods and services to dominant shareholders at excessively low prices, or 3) when controlling shareholders arrange loans to or from the company on advantageous terms (Nenova and Hickey, 2006).

“In-group transactions” arise 1) when a subsidiary supports its parent by purchasing goods from it at non-market prices, 2) when a subsidiary guarantees the debt of its parent, or 3) when it makes loan to its parent without proper collateral. Such in-group transactions indirectly serve the interests of controlling shareholders and help the controllers to control a business group. This taxonomy will be relevant when we discuss sentencing bias for chaebols and civil-law hypothesis.

Data Sources

Our unique defendant-level dataset contains 252 white-collar offenders who committed crimes from 1993 to 2006 and were adjudicated from 2000 to 2007. The dataset involves several high-profile corporate fraud cases such as Samsung, Hyundai Motor Company, and SK group. All our cases are about criminal convictions in the lower and high courts of Korea.

About 40% of the sample corporate crimes occurred around the 1997 financial crisis. The crisis was triggered in part by the unforeseen bankruptcies of several chaebols. To prevent the failure from spreading to the national economy and creating systemic risk, the Korean government had to aid insolvent financial institutions. After the bailouts, the government investigated those responsible for the crisis, took them to court and launched a special task force (called *gongjukjagumjosabang*) in response to the public wrath against conglomerates. The special force aimed to investigate and charge prominent individuals such as controlling shareholders and the CEOs of chaebols and their subsidiaries.

A prototypical example is Daewoo, the second largest business group in Korea at that time. In 1999, the group collapsed under the debts totaling more than $80 billion. Its founder, Kim, Woo-Jung, fled the country and was on the run for six years. The collapse of Daewoo inflicted enormous damages. Its lenders including several large banks almost went bankrupt, thousands were laid off, and myriad lives were disrupted. The task force charged Mr. Kim and seven of his lieutenants with criminal offenses.

Constructing the dataset was laborious; law enforcement authorities do not disclose centralized record on such criminals. We cannot but help constructing the dataset using three distinct sources instead as follows.

NGO Reports and News Coverage

We used special reports of People's Solidarity Participatory Democracy (PSPD) and Solidarity for Economic Reform (SER), civic watchdogs dedicated to monitoring corporate fraud in Korea.[6] The reports contain detailed information on many high-profile corporate crimes. We

[6]The SER's reports can be found at http://www.erri.or.kr/report/report_view.php?code=economy&rpt_seq=16&pageNo=1&searchField=RPT_TTL&searchString=%C8%AD%C0%CC%C6%AE

The PSPD's reports can be found at http://www.peoplepower21.org/PSPD_press/778722

then turned to news coverage. Our samples were selected from newspaper articles published between 2000 and 2007. We used the string {"embezzlement OR breach of fiduciary duty" "the court decisions OR sentencing"} in a web-based news archive (http://www.kinds.or.kr).

Judicial Decisions

We built a unique dataset extensively reviewing judicial decisions. We highlight the criminal's standing: Is he involved with an affiliate of a conglomerate? Is he a dominant shareholder or in top management? We infer criminal conduct from the court decisions; the amount of losses the criminals inflicted on victims, and the compensation for the losses. This may predict sentencing outcomes. For instance, the size of monetary loss can inform how serious an economic crime is. Whether a criminal monetarily redeems the losses is also important in sentencing. Indeed, the Korean judiciary details in the written court decisions what factors it considers when sentencing. The documents can contain a couple of paragraphs or several pages. Our analysis is unique because it contains such comprehensive information in sentencing opinions, which is unavailable in US.

Internet Legal Resources

To track defense attorneys' careers, we use Lawnb (http://www.lawnb.com), a Korean version of Westlaw and Lexis, and identify career paths of defense attorneys such as when a defense lawyer passed the entrance exam; whether he/she is a former judge (or prosecutor) or not; what positions he/she held in the judiciary; and whether he/she is a lawyer in the top-10 law firms. This career information indicates the quality of legal representation.

VARIABLES AND EMPIRICAL SPECIFICATION

This section explains the variables used in the empirical analysis. We characterize a criminal's standing with whether he is an executive in a chaebol and is a controlling shareholder. We present three measures to evaluate the legal representation available to defendants. See Table 4 for the description on the variables.

Dependent Variables

Our first dependent variable is the suspension of prison terms. The variable Imprisonment is 1 if a convicted defendant receives an actual prison term and 0 if he/she receives a suspended

sentence. Why do we highlight the suspension of a sentence rather than acquittal? For those convicted with white-collar offenses, the suspension of jail terms is tantamount to acquittal in Korea. First, the Korean criminal justice has few public officers to supervise all those who received suspended sentences. Accordingly, the offenders may violate their terms without being detected. Thus, suspended sentences are not likely to be resumed.

Second, as noted in the Samsung case, controlling shareholders can return to management upon receiving suspended sentences. A biased judge tends to order a suspended prison sentence instead of acquittal. Judges hardly ever release a guilty defendant outright even though they are biased towards chaebols. Should judges do so, high courts could reverse the lower court decision. Hence, it is more 'convenient' to use the suspension of jail term.

Our second dependent variable is pre-trial status. The variable Pre-trial Detention is 1 if a defendant is under pretrial custody and 0 otherwise. Pretrial detention outcomes inform judicial bias during pre-trial procedures on how the judiciary addresses corporate crimes and how investigating authorities deal with them. A prosecutor exercises vast discretion in deciding whether a suspect is put under detention and what charges to bring if they decide to seek an indictment. Moreover, the Korean criminal justice system has no equivalent of grand jury indictments, indicating that a prosecutor holds exclusive authority over whether to drop a case.

Our third dependent variable measures the severity of punishment, Length of Imprisonment, the time spent in confinement. If a defendant receives a suspended jail term, the length of imprisonment is set to zero because, as explained above, suspended jail terms are essentially equivalent to acquittal.

Explanatory Variables

Chaebol

A chaebol indicates family-owned business group (Granovetter, 1995; Khanna and Rivkin, 2001). Its administrative definition is most clear. The Korea Free Trade Commission (KFTC) has publicly announced the list of chaebols each year since 1987 for regulation. The listing criteria have varied over time. From 1987 to 2001, the KFTC annually ranked the top 30 chaebols based on the total combined assets of all affiliates. Since 2002, the term chaebol means any business group with the total combined assets of its affiliates surpassing KW 5 trillion (approximately USD 5 billion). The KFTC requires chaebols to disclose the identity of a controlling shareholder,

their structures and affiliates' financial statements and other material information. All information is publicly available through the KFTC website.[7]

The variable chaebol is 1 if a firm is an affiliate of a chaebol, and 0 otherwise. Besides chaebols, there are small- or medium-sized family-controlled firms in Korea. Accordingly, when a firm of our sample is not a chaebol affiliate, the firm can still be under the control of a specific family and have a controlling shareholder.

Controlling Shareholder

The KFTC identifies controlling shareholders of chaebols as a founder or his family members. The family members are often placed in top management team such as the CEO or CFO of an affiliate (Morck, Wolfenzon, and Yeung 2004). If a controlling shareholder is also a top executive, we classify him as a controlling shareholder, not as top executives. Top executives in our sample refer to those without any blood ties to the company founders. The variable Controlling shareholder is 1 if a defendant is a controlling shareholder or the controlling shareholder's family members, and 0 if a defendant is a high-ranking non-family executive.

Amount of Losses

"Loss" means the monetary value of harm. The court decides the amount of loss that a defendant caused. For a case with multiple defendants, the total amount of monetary losses is attributed to all of them because all defendants convicted of a same crime are jointly responsible for the loss as a whole. This corresponds to sentencing practices in a trial court, where each defendant is accountable for all the losses incurred by his criminal conduct (Richman, 2013). We specify the Amount of Losses as the log of [the monetary losses+1] that a defendant caused.

No Compensation

The variable No Compensation is 0 if defendants fully restore the losses they incur and 1 otherwise. If defendants compensate victims monetarily, the Korean court considers it as a sign of taking responsibility for offenses and as an important mitigating factor in sentencing.

Quality of Legal Representation

NL (LnNL): The variable NL means the number of attorneys assisting each defendant. LnNL is a logarithm of NL. The size of a defense team indicates the quality of legal

[7]http://groupopni.ftc.go.kr/index.jsp

representation although it does not consider the heterogeneous abilities of attorneys. The following measures consider the heterogeneities.

Top10 ratio: 'Top10 ratio' is (number of lawyers from top-10 law firms)/(total number of lawyers representing each defendant) indicating whether a defendant hires lawyers from top10 law firms. Top 10 law firms have significant resources and experts, and may lead to more leniencies for defendants.

HPL ratio: HPL indicates the total number of ex-senior judge (or public prosecutor) lawyers representing each defendant. HPL ratio is the ratio, HPL/NL. These measures reflect how the Korean justice system selects its judiciary. The careers of judges (or public prosecutors) can provide reliable information about the talent of defense lawyers.

Empirical Specification

We present three regressions. The first regression examines how the courts address corporate fraud offenders; the second investigates how investigatory authorities and the courts deal with such offenders during pre-trial proceedings; the third analyzes the intensity of criminal sanctions against white collar offenders. Thus, these regressions examine how the criminal justice system addresses white collar criminals.

The first and second regressions use nearly identical independent variables except that the second ignores whether a criminal compensates victims monetarily, which is reasonable because compensation is generally made before a verdict is reached, rather than before a trial begins. At the moment of deciding pre-trial detention, public prosecutors and magistrates cannot consider compensation. We use logit models as:

$$Imprisonment = a + b_1\ Chaebol + b_2\ Controlling\ Shareholder + b_3\ No\ Compensation + b_4\ Amount\ of\ Losses + Other\ control\ variables + e,$$

$$Pretrial\ Detention = a + b_1\ Chaebol + b_2\ Controlling\ Shareholder + b_3\ Amount\ of\ Losses + Other\ control\ variables + e.$$

The third regression investigates the duration of actual confinement using the Tobit model. We model that a sentencing judge makes two-stage decisions. First, the judge decides whether a defendant should receive suspended or actual jail terms. Second, the judge decides the length of

imprisonment. The two-stage decision procedure can be described as Y = max(0, Y*), where Y* is the duration of a prison term (measured by months).

$$\textit{Length of Imprisonment} = a + b_1\,\textit{Chaebol} + b_2\,\textit{Controlling Shareholder} + b_3\,\textit{No Compensation} + b_4\,\textit{Amount of Losses} + \textit{Other control variables} + e.$$

We predict that the probability of suspended imprisonment is negatively associated with the size of losses, but positively related to the reparation for losses and the quality of legal service. Given the corporate governance structures of a chaebol, de-facto and substantial decision-making power lies in the hands of controlling shareholders. Thus, we expect that the probability of imprisonment is positively related to the offenders being a controlling-shareholder.

The coefficient for chaebol throughout the paper is b_1. If a sentencing court is unbiased and fair, b_1 should not be different from zero; a chaebol itself is a just economic characteristics of the firms connected with the criminals. It is not an offense or offender-related characteristic. Hence, if b_1 is not zero, sentencing bias exists in the judiciary.

DESCRIPTIVE STATISTICS AND BASIC RESULTS

Descriptive Statistics

We have defendant-level data. Our dataset consists of 252 Korean white-collar offenders. Panel B in Table 5 reports that 143 defendants were convicted in district courts. Of the 143 defendants, 42 were sentenced to actual jail terms, whereas 101 were given suspended jail terms. 39 of 42 defendants subject to prison terms appealed to high courts. Of 101 criminals receiving suspended jail terms in district courts, 57 cases moved to higher courts because prosecutors appealed. Prosecutors appeal when they assess sentences as excessively light. We have 13 defendants whose cases involve appeal courts only. Therefore, the total number of defendants in high courts is 109 (see Table 5-Panel C). Thus, we have 252 cases in total. As can be seen in

Figure 1, there exist variations over time in the number of adjudicated cases. Between 2003 and 2005 63% (158 out of the 252) of cases were sentenced.

In Table 5, chaebol-related criminals account for 56% of our sample (140 out of 252). Non-chaebol criminals represent 44%. Controlling shareholders are 49% and top management 51% respectively. When chaebol-related offenders are convicted, the less likely they are to receive prison sentences. Non-family top management defendants receive lighter punishment than controlling shareholders. Table 6-Panel A shows that about a quarter of the convicted defendants (65 out of 252, 25.7%) served prison terms. Of the convicted chaebol-related offenders, 20.7% (29 out of 140) received prison sentences; of their convicted non-chaebol counterparts, 32.1% (36 out of 112) received prison sentences.

Notable sentencing disparities exist between controlling shareholders and professional top managers. See Panel A at Table 6; out of the convicted non-family high-profile executive defendants, 4.7% (6 out of 127) received actual prison sentences. However, out of convicted controlling shareholder defendants, 47.2% were given prison terms (59 out of 125). Panel C in Table 6 is more dramatic. No convicted top management was incarcerated; and all prison sentences on top management were later suspended by appeal courts.

Similar patterns exist in pre-trial procedures. In Table 7, 44.8% (66 out of 147) of defendants were detained during trial procedures. Among them, non-chaebol-connected defendants are twice as many detained as chaebol-connected defendants (62.2%, 38/61 versus 32.5%, 28/86). In addition, 72.3% (47/65) of controlling shareholders were detained while 23.1% (19/82) were of non-family top managers.

The quality of legal counsels differs between chaebol-connected and non-chaebol defendants. As seen in Figure 2, chaebol-related defendants receive higher quality legal assistance. The differences are significant at 1% level for all except NL significant at 10%.

Observing this circumstance, some may argue that the access to legal resources causes the aforementioned sentencing gaps. Indeed, at the time of investigation, better-qualified attorneys defend the deep-pocketed chaebol-connected defendants from very early stages. Chaebol-connected defendants might win lenient sentences because good lawyers represent them, not because the Korean justice system favors them. Given these competing possibilities, the next

section examines whether the sentencing biases for chaebols originate from judicial bias (judicial size premium) or from high quality legal representation.

Regression Results

Table 8 shows the baseline results. The Korean judiciary is significantly biased for chaebols from pre-trial to trial procedures ($b_1 < 0$ for all cases). The coefficients for the control and the other independent variables correspond to our prediction. The variable No Compensation is positively related with the incarceration probability of the convicted corporate criminals. The likelihood that convicted defendants receive suspended jail terms increases by 14% with restitution. The variable Amount of Losses is positively correlated to imprisonment probability. The bigger the monetary loss, the more likely the convicted offenders are incarcerated. As losses increase by USD 0.1 million, imprisonment probability increases by 4%p; the length of imprisonment increases by 3.8 month.

Our baseline results remain robust after controlling for the quality of legal representation. See Table 9, Table 10 and Table 11. The coefficient for the chaebol dummy is significantly negative ($b_1 < 0$ for all cases). Table 9 analyzes the probability of imprisonment while controlling for the number of attorneys assisting each defendant (LnNL), number of lawyers from top-10 law firms over total number of lawyers representing each defendant (Top10ratio) and the total number of ex-senior judge (or public prosecutor) lawyers representing each defendant (HPL ratio).

Table 10 and Table 11 examine probability of pretrial detention and length of imprisonment with the legal qualities controlled for. About the probability of imprisonment, HPL ratio significantly decreases imprisonment. However, the size of chaebol bias remains almost the same. Concerning pre-trial detention, none of the quality measures are significant. However, the length of imprisonment, Top10 ratio and HPL ratio are significant while the chaebol bias does not change much after controlling for the legal qualities.

ANALYSIS ON THE SOURCE OF TOO-BIG-TO-JAIL

Results of Analysis on Mitigating Circumstances

This section examines sentencing opinions and considerations. Mitigating factors can identify judicial perceptions of corporate crimes unlikely to be captured in regressions analyses. We find that this qualitative analysis strengthens our findings in the previous sections.

Table 13 shows our results. The most widely accepted defense, found in 145 out of 232 cases, is voluntary compensation for losses made to victims. The next one is "no-private-gain" defense which defendants use for all illegal in-group transactions and argue that their conduct is for the interests of a whole business group (e.g., to prop up troubled affiliates in the group), not for themselves. This claim involving outlawed in-group self-dealing exists in 135 out of 232 cases. The third defense is that a defendant has no criminal record. The fourth is "acceptance-of-responsibility" defense that defendants would take the responsibility for their crimes.

In sum, our qualitative analysis reaffirms and supplements the chaebol bias. First, the voluntary payment of restitution mitigates sentences. This increases the leniency for the chaebol-linked defendants with vast financial resources. Second, clean criminal record and philanthropic activities (or contributions to the economy) are mitigating factors. The latter is more useful to rich chaebol-connected defendants than to other defendants. APPENDIX 1 shows the mitigating factors in detail. In the subsequent subsection, we attempt to answer one of the research questions in this paper: Why does the judiciary produce the chaebol bias or too-big-to-jail sentences?

Validating the Systemic Risk Hypothesis

In our systemic risk hypothesis, light criminal penalties are simply connected to the size of chaebols (too-big-to-jail) just as large bailout is connected to the size of systematically important financial institutes (too-big-to-fail, Mishkin 2006). This size hypothesis is valid in the Korean context.

First, large chaebols contribute to the national economy substantially. The total sales of the top 4 family business groups (Samsung, Hyundai Motor Company, LG, and SK) contribute to 49.2% of GDP; the total assets of their affiliates amount to 43.5% of GDP in 2005 (Solidarity for Economic Reform 2009). Since a few wealthy families manage chaebols, judges worry that harsh sentences against the tycoons may engender economy-wide systemic risk. Our qualitative results exactly show this pattern.

Second, chaebols are structured to greatly affect the Korean economy. The affiliates in a chaebol are interconnected through complex cross-shareholding (Chang 2003; Almeida et al. 2011). A problem in an affiliate can quickly spread out to other affiliates and to the overall economy. Thus, chaebols are systematically important economic organizations (SIEOs). Just as systematically important financial institutions (SIFIs) can undermine the confidence on the overall financial system, so the systematically important business groups can disrupt the national economy. Therefore, this too-big-to-jail concern of the judiciary leads to judicial bailout, e.g., suspended sentences and shorter prison terms for chaebols.

In Table 14, however, the chaebol bias is not stronger for the particularly systematically important top 10 business groups than for those outside of that ranking. In addition, an individual firm's total asset at which a convicted defendant works is not statistically significant. It is debatable that the systemic risk comes from simply the size of family business groups or an individual firm.

It is possible to explain that the chaebol effect exists because the systemic risk of the chaebol is coming from financial characteristics of an individual firm. These measures would test the portion of the 'chaebol effect' that comes from how important the firm is to the market as a whole. These firm level effects capture of the prominence of the firm and its effect on market stability.

In Table 13, we test the difference between chaebol and non-chaebol in terms of debt structure and performance measured by total debts divided by assets, ROA and sales growth. [8]There is significant difference between chaebol and non-chaebol firms. In Table 14, we regress the effect of debt structure and performance on the judicial decision. Our findings show that the judiciary is generous for the highly leveraged and better performed firms.

8 We could not collect the financial information of our full sample firms because some firms in our sample has not survived.

Validating the Civil Law Hypothesis

The expropriation of minority shareholders happens more in civil law countries than in common law countries. The civil law system is less suspicious of related party transactions than the common law, and, therefore, subjects them to more lenient regulatory and legal scrutiny. Civil law courts more tolerate the transactions between affiliates that hurt minority shareholders (e.g. López de Silanes et al. 1999; López de Silanes et al. 2000; Djankov et al. 2008).

Long standing legal principles on fiduciary duty may lead common law countries more critical to self-dealings (Johnson et al 2000). Enriques (2000) argues that self-dealings are more likely to occur in common law countries because expected benefits from self-dealings are higher there.[9] While self-dealings are subject to profit disgorgement in the common law countries such as U.S. and U.K., continental Europe only imposes liability for the damages. In conclusion, the prior literature suggests that the Korean civil law system can cause the chaebol bias, or too-big-to-jail pattern.[10] Our analysis confirms this.

First, in Table 13, outlawed in-group transactions occur overwhelmingly by chaebol-related defendants. In contrast, there is no significant difference between chaebol and non-chaebol offenders in committing embezzlement and "narrowly defined self-dealing". Second, for chaebol-related cases, the "no-private-gain" defense is the most commonly accepted claim, made in 94 out of 132, despite the damages to minority shareholders. This defense appears for all in-group transaction cases. In addition, this defense is the only claim accepted more for chaebol-related cases than for non-chaebol cases at 1% significance. This is not found in other claims such as the "voluntary-compensation-for-losses" defense and the "no criminal records" defense.

To summarize, chaebol-related defendants commit illegal in-group transactions much; they defend themselves using "no-private-gain" defense; and the civil-law Korean court accepts

[9] "... in continental Europe a generic violation of the duty of loyalty gives rise only to liability for the resulting damages to the company, whereas in the US and in the UK, duty-of-loyalty violations are also subject to the remedy of disgorgement of profits, so that the prophylactic potential of the latter countries' civil remedies is higher" (Enriques, 2000:303).

[10]Some may argue that leniency towards large firms is not attributed to civil law traditions because too-big-to-jail is also observed in the United States where common-law practices prevails. However, too-big-to-jail we investigate is different from that of the United States. While the Korean too-big-to-jail is mainly related to judicial adjudications, observed leniency in the U.S. involves prosecutorial decisions not to bring cases to the court, i.e., too-big-to-prosecute.

this defense much, which in turn increases the incentive for chaebols to undertake dubious in-group transactions. This finding logically corresponds to the prior literature on the protection of minority shareholders in civil and common law countries.

Second, we test the civil law hypothesis using regression analysis. Table 13 and Table 14 suggest that the Korean judiciary reviews related-party transactions considering the interests of the business group rather than those of (minority) shareholders of each affiliate. The criminals justify the related-party transactions in the name of plausible business purpose, i.e., group management or the management of constituent companies to enhance the overall interest of the group ("no-private-gain" defense). Then, the court treats such convicted criminals generously by deeming this circumstance as a mitigating factor and, as a result, sentences leniently.

More specifically, the in-group transaction dummy, taking 1 if the "no-private-gain" defense is accepted and 0 otherwise, lowers incarceration. Quantitatively speaking, column (3) in Table 14 shows that the in-group transaction dummy lowers the probability of incarceration by 10%p.

More about the Chaebol Effects

The judicial bias exists because of the social connections of the chaebol (i.e., "too-connected-to-jail"). We measure the degree of social connections of board members. In Table 15, we find that having former prosecutors or judges on the board does not have any effects on the judiciary decisions. These findings suggest that existing social connections among legal professionals may not be a potential channel of judicial bias.

CONCLUSION

We explore interactions between legal and economic systems. Our unique dataset about Korean corporate crimes reveal 'size premium' and its magnitude in the judiciary. The larger the business group, the more lenient the courts become for the offenders associated with the groups. These findings are robust to various covariates and across the measures on the quality of legal representation. We hypothesize and confirm that such 'too-big-to-jail' occurs because (1) the

judiciary concerns that harsh sentences against business groups can cause systemic risk to the economy; (2) it adheres to the civil law tradition, unwilling to regulate in-group transactions.

Our results offer policy implications. Large firms benefit from implicit judiciary guarantee (too-big-to-jail); this leads the firms to become further large and untouchable as they develop into systematically important economic organizations. Both regulatory authorities and the judiciary can fail to manage this too-big-to-jail problem ex-post. Instead, ex-ante 'governance-prudential' measures could reduce these problems.

Our study leaves future research topics. Previous studies about too-big-to-fail indicate moral hazard problems, whether and how the expectations of too-big-to-fail distort the behavior of market participants (Stern and Feldman 2004; Mishkin 2006). Similar is the too-big-to-jail, which creates a moral hazard problem for the managers in big firms. A controlling shareholder has strong incentives for size-maximization rather than for profit-maximization in order to obtain judicial bailout. Firms expand their size for reasons other than the realization of economies of scale. How legal factors interact with corporate governance can motivate theoretical research. In addition, future study can consider the ambitions and private incentives of judges and prosecutors. Finally, future research can design governance-prudential regulations aimed to mitigate systematic risk.

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Table 1: "Too- Big-To-Fail" vs. "Too-Big-To-Jail"

	Too big to fail	Too big to jail
Main governing branch	An executive or central bank	The judiciary
Definition	A government props up systemically important financial institutions such as large and interconnected banks.	The judiciary issues favorable rulings for the top managers in economically significant business organizations such as business groups.
Advantages	An economy can avoid the abrupt or disorderly break down of financial and economic system. Banks can pursue economies of scope and scale facing less uncertainty and externality.	An economy can avoid the disorderly failure of large economic organizations and keep them stable. Large firms can avoid the risk of making decisions without leadership.
Problems	Significantly important financial institutions can undertake high-risk high-return projects in expectation of bailout upon failure. Creditors have the incentive to increase loans while having less incentive to monitor large financial institutions. Competition between large and small firms becomes distorted.	Large economic organizations can undertake legally questionable, but profitable deals in expectation of lenient judicial rulings. Business partners have incentive to engage with large firms believing the deals are legally safer and less challenged. Competition between large and small economic organizations becomes distorted; More and more transactions are internalized in large economic organizations in expectation of judicial leniency.
Long-term consequence	Financial institutions have the incentive to increase their size and interconnection for preferential policies. Too-big-to-fail firms can become a source of risks to economic and financial system	Economic organizations have the incentive to increase their size, reach and interconnectedness for preferential judicial rulings. Too-big-to-jail firms create societal and political problems as well as corruption and injustice.

Table 2: Top 30 Chaebols in Korea

Year	Total Assets(A)	Total Sales(S)	Total No. of Affiliates	Average No. of Affiliates	GDP	A/S*100	S/GDP *100
1980	20.7	23.7	417	13.9	39.1	52.9	60.6
1987	56.6	84.9	509	16.4	100.2	56.5	84.7
1991	125.3	231.3	570	19.0	191.3	65.5	120.9
1995	233.4	345.0	623	20.8	349.9	66.7	98.6
1999	463.5	479.3	686	22.9	501.0	92.5	95.7
2001	564.6	510.1	624	20.8	603.2	93.6	84.6
2006	770.0	629.4	645	21.5	865.2	89.0	72.7
2011	1460.5	1134.0	1019	34.0	1172.8	124.5	96.7

Total Assets and Total Sales means the summation of assets of top 30 Chaebols. Total No. of Affiliates is the number of affiliated firms housed in top 30 Chaebols. Average No. of Affiliates is the average number of affiliated firms in top 30 Chaebols. GDP is measured by 2005 constant year price. A unit is KW10 trillion (approximately USD 10 billion) and %, respectively. We use data of Korea Free Trade Commission.

Table 3: Total Number of Judges and Prosecutors in Korea by Ranks

Panel A: Total Number of Judges in Korea by Ranks (as of 2013)

	Ranks	Number (% all judges)
Justice	Supreme Court Justice	14 (0.5)
Chief Judge	High court (or Patent court) Chief Judge	6 (0.2)
	District court (or Administrative and Family court) Chief Judge	24 (0.8)
Senior Judge	High court (or Patent court) Senior Judge	117 (4.1)
	Branch court Senior Judge	39 (1.4)
	District court (or Administrative and Family court) Senior Judge	473 (16.6)
Junior Judge	Law Clerk of Justice	105 (3.7)
	High court (or Patent court) Junior Judge	205(7.2)
	District court (or Administrative and Family court) Junior Judge	1,875 (65.6)
	Total	2,858 (100.0)

There are 14 "Supreme Court Justices". The proportion of "Supreme Court Justices" over all judges in Korea is 0.5%. The number of "District court (or Administrative and Family court) Senior Judges" is 473, which is 16.6% of all judges in Korea. The number of "District court (or Administrative and Family court) Junior Judges" is 1,875. The proportion is 65.6%. Data is from *Bubwonjojikbub* (The Judicial Organization Act). Other numbers are computed in the same way.

Panel B: Total Number of Public Prosecutors in Korea by Ranks (as of 2012)

	Ranks	Number (% all prosecutors)
Justice	Prosecutor General	1 (0.0)
Chief Prosecutor	Deputy Prosecutor General	1 (0.0)
	High Prosecutor Office Chief Prosecutor	5 (0.3)
	Supreme Prosecutor Office Prosecutor, High Prosecutor Office Deputy Prosecutor & District Prosecutor Office Chief Prosecutor	30 (1.5)
Senior Prosecutor	High Prosecutor Office Senior Prosecutor	3 (0.2)
	District Prosecutor Office Chief Prosecutor	24 (1.2)
	District Prosecutor Branch Office Chief Prosecutor	24 (1.2)
	District Prosecutor Office Deputy Prosecutor, District Prosecutor Office or District Prosecutor's Branch Office Senior Prosecutor & High Prosecutor Office Prosecutor	330 (16.9)
Junior Prosecutor	District Prosecutor's Branch Office Chief Prosecutor	16 (0.8)
	Prosecutor for Research	39 (2.0)
	District Prosecutor's or its Branch Office Junior Prosecutor	1,469 (75.6)
	Total	1,942 (100.0)

There are five "High Prosecutor Office Chief Prosecutors". The proportion of "High Prosecutor Office Chief Prosecutors" over all public prosecutors in Korea is 0.3%. The number of "District Prosecutor's Branch Office Senior Prosecutor & High Prosecutor Office Prosecutor" is 330, which is 16.9% of all public prosecutors in Korea. The number of "District Prosecutor's or its Branch Office Junior Prosecutor" is 1,469. The proportion is 75.6%. Other numbers are computed in the same way.

Table 4: Definitions and Descriptive Statistics for the Variables

Panel A: Variable Definitions

Variable	Definition
Imprisonment	1 if a convicted defendant is actually jailed, and 0 if he/she receives a suspended jail term
Pre-trial Detention	1 if a defendant is under pretrial custody, and 0 otherwise
Length of Imprisonment	The length of actual confinement of a defendant when he/she is found guilty
Chaebol	1 if a firm for whom a convicted defendant works is affiliated with a chaebol, and 0 otherwise
Controlling shareholder	1 if a convicted defendant is a founder or his/her family member , and 0 if he/she is non-family top management
Amount of Losses	Ln (Monetary losses which a defendant inflicts on a firm+1)
No compensation	0 if losses from crises are fully restored, and 1 otherwise
NL	Total number of defense lawyers representing each defendant
LnNL	Ln(NL+1)
HPL	Defense attorneys with senior judge (or public prosecutor) assisting each defendant
HPL ratio	The ratio of HPL to NL
Top10	Defense attorneys from a top-10 law firm assisting each defendant
Top10 ratio	The ratio of Top10 to NL

Panel B: Descriptive Statistics for the Variables

Variable	N	No of "1" values (if a variable is dummy)	Mean	S.D.	Min	Max
Imprisonment	252	66	.26	.44	0	1
Pre-trial Detention	147	66	.44	.49	0	1
Length of Imprisonment (Month)	252		32.8	13.4	0	96
Length of Imprisonment (Month, Actually served)	66		45.3	17.4	18	96
Chaebol	252	144	.57	.49	0	1
Controlling shareholder	252	125	.49	.50	0	1
Amount of Losses	252		5.19	2.76	.69	14.85
No compensation	252	211	.83	.36	0	1
NL	252		4.1	3.2	1	18
LnNL	252		1.13	.78	0	2.89
HPL	252		1.8	.1.5	0	9
HPL ratio	252		.48	.32	0	1
Top10	252		2.4	3.2	0	16
Top10 ratio	252		.47	.46	0	1

Panel A shows a definition for the dependent and explanatory variables. Imprisonment, Pre-trial Detention, and Length of Imprisonment are the dependent variables. The others are all explanatory variables. NL, LnNL, HPL, HPL ratio, Top10, and Top10 ratio indicate the quality of legal representation. Panel B shows the descriptive statistics for the variables. For instance, the mean of Imprisonment is .26 (a convicted defendant actually jailed in our sample is 26%). The mean of Length of Imprisonment (Month, Actually served) is 45.3 month, or the average length of actual confinement of a defendant when he/she is found guilty is 45.3 month. The mean of Chaebol dummy is .57, i.e. 57% of convicted defendants in our sample work at chaebol-affiliated firms. The mean of NL is 4.1, i.e. the average number of defense lawyers representing each defendant is 4.1. The mean of HPL is 1.8; the average number of defense attorneys with senior judge career (or public prosecutor career) assisting each defendant is 1.8.

Table 5: White-Collar Criminals by Position and Type of Affiliation

Panel A: White-Collar Criminals by Occupational and Social Position (N=252)

	Chaebol	Non-Chaebol	Total
Controlling shareholder	59	66	125
Top management	81	46	127
Total	140	112	252

Panel B: White-Collar Criminals by Occupational and Social Position: Low Court Cases (N=143)

	Chaebol	Non-Chaebol	Total
Controlling shareholder	32	32	64
Top management	53	26	79
Total	85	58	143

Panel C: White-Collar Criminals by Occupational and Social Position: High Court Cases (N=109)

	Chaebol	Non-Chaebol	Total
Controlling shareholder	27	34	61
Top management	28	20	48
Total	55	54	109

In Korea, controlling shareholders are mostly the founder of a firm or his/her family members. Top management refers to non-family CEO (or high-profile executive) or director. A controlling shareholder may serve as the CEO or director of an affiliate. In this case, he/she is classified as a controlling shareholder.

Table 6: White-Collar Criminals by Affiliation and type of Punishment

Panel. A: White-Collar Criminals by Type of Punishment (N=252)

	Suspended Jail Terms		Actual Jail Terms	
	Non- Chaebol	Chaebol	Non- Chaebol	Chaebol
Top Management	42	79	4	2
Controlling Shareholder	34	32	32	27
Subtotal	76	111	36	29
Total	187		65	

Panel. B: White-Collar Criminals by Type of Punishment: Low Court Cases (N=143)

	Suspended Jail Terms		Actual Jail Terms	
	Non- Chaebol	Chaebol	Non- Chaebol	Chaebol
Top Management	22	51	4	2
Controlling Shareholder	13	15	19	17
Subtotal	35	66	23	19
Total	101		42	

Panel. C: White-Collar Criminals by Type of Punishment: High Court Cases (N=109)

	Suspended Jail Terms		Actual Jail Terms	
	Non- Chaebol	Chaebol	Non- Chaebol	Chaebol
Top Management	20	28	0	0
Controlling Shareholder	21	17	13	10
Subtotal	41	45	13	10
Total	86		23	

A controlling shareholder is generally a founder of a firm or his/her family members. Top management refers to a non-family CEO (or high-profile executive) or director. A controlling shareholder may serve as the CEO or director of an affiliate. In this case, he/she is classified as a controlling shareholder.

Table 7: White-Collar Defendants by Pretrial Custody

	No Pretrial Custody		Pretrial Custody	
	Non-Chaebol	Chaebol	Non-Chaebol	Chaebol
Top Management	17	46	11	8
Controlling Shareholder	6	12	27	20
Subtotal	23	58	38	28
Total	81		66	

A controlling shareholder is generally a founder of a firm or his/her family members. Top management refers to a non-family CEO (or high-profile executive) or director. A controlling shareholder may serve as the CEO or director of an affiliate. In this case, he/she is classified as a controlling shareholder.

Table 8: Regression Results for Chaebol bias

Dependent Variable	(1) Imprisonment	(2) Pre-trial Detention	(3) Length of Imprisonment
Chaebol	-.47** (.23)	-.85*** (.24)	-19.5** (8.1)
Controlling Shareholder	1.59*** (.23)	1.12*** (.24)	63.7*** (8.5)
No Compensation	.77** (.35)		33.0** (13.5)
Amount of Losses	.18*** (.05)	.11** (.04)	7.5*** (1.8)
Instance fixed effect	Y	N	Y
Constant	-2.82*** (.96)	-.72* (.20)	-107.4*** (-21.3)
Observations	252	147	252

"Imprisonment" indicates a dummy variables taking 1 if a convicted defendant is actually jailed, and 0 if he/she receives a suspended jail term. "Chaebol" denotes a variable taking 1 if a firm for whom a convicted defendant works is affiliated with chaebol, and 0 otherwise. "Controlling Shareholder" has 1 if a convicted defendant is a founder or a member of a founding family, and 0 if he/she is non-family top management (e.g. CEO or CFO). "Amount of Losses" is equal to ln (Monetary losses which a defendant inflicts on a firm+1). "No Compensation" has 1 if the losses from crimes are not fully reimbursed, and 0 otherwise. "Instance" has 1 if a trial court is an appeal court, and 0 if the court is a lower the court. ***, ** and * indicate significance at the 1%, 5% and 10% levels, respectively. Robust standard errors are in parentheses.

Table 9: Regression Results for the Probability of Imprisonment

Panel A Dependent Variable=Imprisonment	(1)	(2)	(3)
Chaebol	-.50** (.22)	-.35 (.23)	-.47** (.23)
Controlling Shareholder	1.52*** (.24)	1.64*** (.25)	1.62*** (.24)
No Compensation	.85** (.36)	.70* (.36)	.85** (.35)
Amount of Losses	.18*** (.05)	.20*** (.06)	.19*** (.05)
LnNL	.18 (.14)		
Top 10 ratio		-.48* (.28)	
HPL ratio			-63** (.31)
Instance fixed effect	Y	Y	Y
Constant	-3.02*** (.49)	-2.71*** (.46)	-2.65*** (.46)
Observations	252	252	252

See Table 4 for variable definitions. ***, ** and * indicate coefficients significantly different from 0 at the 1%, 5% and 10% levels, respectively. Robust standard errors are in parentheses.

Table 10: Regression Results for the Probability of Pretrial Detention

Dependent variable = Pretrial Detention	(1)	(2)	(3)
Chaebol	-.86***	-.86***	-.88***
	(.24)	(.26)	(.24)
Controlling Shareholder	1.12***	1.12***	1.15***
	(.25)	(.24)	(.24)
Amount of Losses	.11**	.11**	.11**
	(.04)	(.04)	(.04)
LnNL	.00		
	(15)		
Top 10 ratio	.	.02	
		(.27)	
HPL ratio			.46
			(.36)
Constant	-.72**	-.72**	-.94**
	(.33)	(.30)	(.36)
Observations	147	147	147

See Table 4 for variable definitions.***, ** and * indicate coefficients significantly different from 0 at the 1%, 5% and 10% levels, respectively. Robust standard errors are in parentheses

Table 11: Regression Results for Length of Imprisonment

Dependent variable =Length of Imprisonment	(1)	(2)	(3)
Chaebol	-20.5*** (7.8)	-14.6* (8.0)	-19.1** (8.0)
Controlling Shareholder	60.5*** (8.6)	64.6*** (8.6)	63.3*** (8.6)
No Compensation	35.6*** (13.7)	29.7** (13.7)	34.9*** (13.4)
Amount of Losses	7.4*** (1.7)	8.0*** (2.0)	7.9*** (1.7)
LnNL	7,3 (4.8)		
Top 10 ratio		-17.7* (9.4)	
HPL ratio			-23.7** (10.3)
Instance fixed effect	Y	Y	Y
Constant	-119.3*** (17.8)	-106.9*** (16.1)	-103.8*** (16.8)
Observations	252	252	252
Sigma	40.2	40.4	40.0

See Table 4 for variable definitions.***, ** and * indicate coefficients significantly different from 0 at the 1%, 5% and 10% levels, respectively. Robust standard errors are in parentheses.

Table 12: Sources of the Chaebol effect; Descriptive Statics for the Defense Accepted by Judge

	Chaebol (N=132)	Non-chaebol (N=100)	P-Value
'Voluntary-compensation-for-losses' defense	0.58 (76)	0.69 (69)*	0.096
'No-private-gain' defense	0.71 (94)***	0.41 (41)	2.52E-06
'No-criminal-history' defense	0.43 (57)	0.57 (57)**	0.03
'Acceptance-of-responsibility' defense	0.47 (63)	0.45 (45)	0.68
'Top-management' defense	0.35 (47)	0.30 (30)	0.371

'Voluntary-compensation-for-losses' defense means the voluntary compensation for losses to victims by convicted criminals. 'No-private-gain' defense indicates that a criminal argues that he acquired no private gain from the crimes and did the in-group transactions for the interests of a whole business group (e.g., propping troubled affiliates in the group). 'No-criminal-history' defense denotes a case in which white-collar offenders have a clean record. 'Acceptance-of-responsibility' defense indicates that convicted defendants apparently accepted the responsibility for their crimes. 'Top-management' defense states that convicted non-family top managers apologize for their involvement in crimes, but claim that they just followed past common management practices as mere employees. P-value shows the outcome of two-sample mean-comparison test.

Table 13: Sources of the Chaebol effect; Descriptive Statics for the Financial Characteristics of a firm at which a convicted defendant works.

	Chaebol	Non-chaebol	P-Value
Leverage	1.79(87)*	0.95(42)	0.0556
ROA	2.94(87)***	-35.90(38)	0.0058
Sales Growth	8.66(87)**	-11.14(38)	0.0223

LnAsset is the natural log of total assets of a firm at which a convicted defendant works. Leverage is the total debt divided by total assets. ROA is return on assets. Sales Growth is the growth rate of total amount of sales. P-value shows the outcome of two-sample mean-comparison test.

Table 14: Sources of the Chaebol effect; Regression Results for the Probability and Length of Imprisonment

	Imprisonment				Imprisonment Length			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Systemic Risk: Size of Business Group or an individual firm								
Top_10	1.04		2.20		24.28		27.04	
	(.95)		(1.94)		(15.37)		(18.51)	
Less Top_10	1.89		2.14		47.67**		34.32*	
	(1.27)		(1.39)		(18.39)		(19.09)	
LnAsset		.29		.08		6.73**		.74
		(.24)		(.26)		(3.26)		(3.91)
Systemic Risk: Financial Characteristics								
Leverage	-.05	.03	-.27*	-.15*	-1.43	.72	-3.84**	-2.34*
	(.06)	(.06)	(.14)	(.08)	(1.10)	(1.18)	(1.59)	(1.37)
ROA	-.01**	-.01**			-.27***	-.27***		
	(.004)	(.004)			(.06)	(.06)		
Sales Growth			-.05**	-.04**			-.67***	-.53**
			(.03)	(.02)			(.22)	(.22)
Civil Law								
Ingroup Transaction	-1.67*	-1.32	-2.16*	-1.57	-32.49***	-27.29**	-38.55***	-32.72**
	(.93)	(.93)	(1.22)	(1.02)	(12.27)	(13.56)	(12.55)	(14.75)
Social Connections								
Former Prosecutor-Judge	-.51	-.65	.89	.91	-5.66	-9.05	7.46	10.84
	(1.32)	(.14)	(1.27)	(1.47)	(16.79)	(17.21)	(15.63)	(20.33)
Observations	98	98	98	98	98	98	98	98

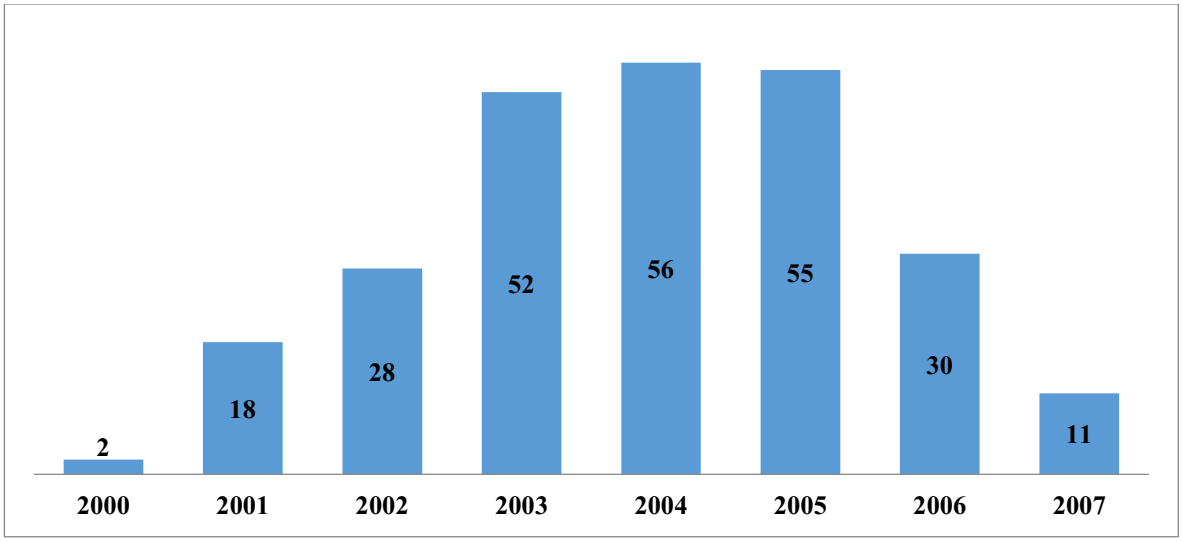
"Top_10" denotes a dummy variable, 1 if a convicted defendant works is affiliated with top 1 to 10 chaebol and 0 otherwise. "Less Top_10" denotes a dummy variable, 1 if a convicted defendant works is affiliated with below top 10 chaebol and 0 otherwise. LnAsset is the natural log of total assets of a firm at which a convicted defendant works. Leverage is the total debt divided by total assets. ROA is return on assets. Sales Growth is the growth rate of total amount of sales. "Ingroup Transaction" denotes a dummy variable, 1 if "No-private-gain" defense is accepted, and 0 otherwise. 'No-private-gain" defense indicates that a criminal acquired no private gain from crimes because the crimes were in-group transactions for the interests of a whole business group (e.g., for propping up troubled affiliates in the group). Former Prosecutor-Judge is a dummy variable that takes the value of one if there is at least one outside director who used to be a judge or prosecutor on the board and zero otherwise. Covariates include the variable Controlling Shareholder, Loss, Instance, No Compensation, Amount of Losses, and the quality of legal assistance. ***, ** and * indicate significance at 1%, 5% and 10% levels, respectively. Robust standard errors are in parentheses.

Table 15: Sources of the Chaebol effect: Social Connections

	Imprisonment				Imprisonment Length			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Chaebol	.75	.67	.67	.85	13.40	12.10	13.45	17.01
	(.67)	(.72)	(.72)	(.86)	(13.06)	(13.64)	(13.17)	(14.83)
Former Prosecutor-Judge	-.67		-.11	-.66	-11.92		-11.49	-13.74
	(.71)		(.78)	(.99)	(12.46)		(12.48)	(15.48)
Former Bureaucrat		-.11	-.11	-.88		3.89	2.55	-5.71
		(.78)	(.78)	(.96)		(11.69)	(11.61)	(13.10)
Board Size	-.16	-.17	-.17	-.15	-2.44	-2.30	-2.30	-1.60
	(.15)	(.15)	(.15)	(.16)	(2.67)	(2.66)	(2.62)	(2.65)
Board Independence	.95	.34	.34	.98	19.81	1.12	16.19	14.28
	(2.07)	(2.31)	(2.31)	(2.38)	(39.33)	(40.71)	(39.90)	(38.13)
Ingroup Transaction				-1.57*				-30.98**
				(.89)				(13.13)
Observations	107	107	107	101	107	107	107	101

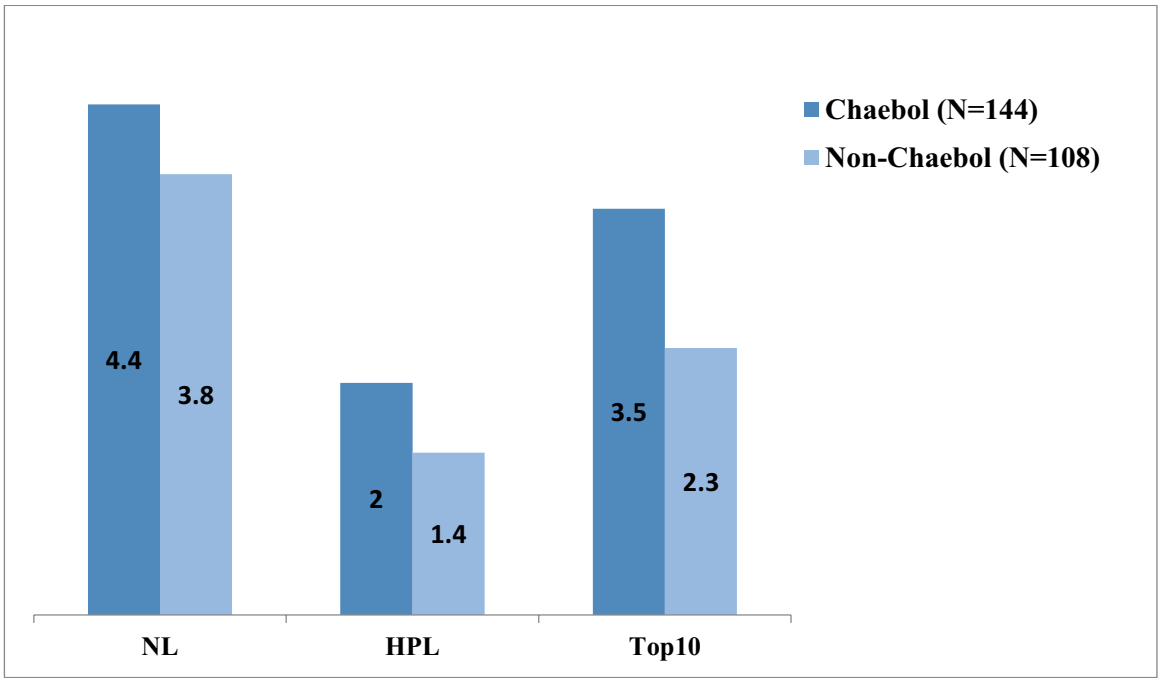
Former Prosecutor-Judge is a dummy variable that takes the value of one if there is at least one outside director who used to be a judge or prosecutor on the board and zero otherwise. Former Bureaucrat is a dummy variable that takes the value of one if there is at least one outside director who used to be a government officer on the board and zero otherwise. Board Size is the number of directors on the board. Board Independence is the proportion of outside directors on the board. Covariates include the variable Controlling Shareholder, Loss, Instance, No Compensation, and Amount of Losses. ***, ** and * indicate significance at 1%, 5% and 10% levels, respectively. Robust standard errors are in parentheses.

Figure 1: Breakdown of Convicted Criminals by Sentencing Year



This figure describes the number of convicted criminals each year in 2000-2007.

Figure 2: Measure of the Quality of Legal Representation



"NL" denotes the number of defense lawyers assisting each defendant on average. "HPL" refers to the number of defense lawyers with senior judge (or senior public prosecutor) experience representing each defendant on average. "Top10" denotes the number of defense lawyers from a top 10 law firm hired by each defendant on average.

APPENDIX 1: DESCRIPTION AND EXAMPLE FOR MITIGATING FACTORS

Factors (No. of observations)	Description	Examples	Critiques
'Voluntary-compensation-for-losses' defense (146)	Judges consider the voluntary compensation that criminals make to victims as important mitigating sentencing factors.[11] Several issues are important. First, courts define the gains from crimes so narrowly as to exclude the private benefits of control. Such criminal gains are not definitive. Second, courts deem restitution arbitrarily. For example, when damages are paid by one of several co-defendants, the courts apply that restitution for the other defendants who have not actually compensated the victims. Third, courts consider compensation as mitigating factors even if restitution occurs prior to adjudication. Thus, it is unnecessary for defendants to make pre-indictment restitution.		This judicial behavior can weaken criminal sanctions to deter crimes and produce opportunistic behaviors. For example, if a crime is undetected, white-collar offenders retain their stolen assets; if detected, they make restitution, which buys them suspended sentence.

[11]Note that the compensation we refer to here differs from the restitution American judges use as criminal sanctions. In Korea, judges, when imposing punishment, can select only two types of criminal penalties: fines and/or imprisonment (with penal labor). Thus Korean judges cannot order defendants to make restitution and give suspended imprisonment on the condition of restitution. A judge can also choose imprisonment without penal labor, which is seldom used in practice.

'No-private-gain' defense (135)	Criminals use this defense very commonly especially in the following circumstances. When crimes take the form of in-group self-dealing transactions to prop up a troubled subsidiary, courts commonly hold that a defendant committed the crimes for the company. Similarly, if founding family members commit the crimes to retain control over a business group, judges generally rule that the crimes are not for private interests.	In the Daewoo group case, a firm obtained loans through accounting fraud. Next the loans were transferred to a troubled subsidiary. The courts claimed that these crimes were not committed for the defendants' private gain. In the Samsung group case, defendants issued equity at unfairly low prices to cede controlling power on the group to controlling shareholder's son. A judge held that the defendants, board directors who approved the equity issue, never intended to gain private benefits from their criminal conduct.	Private benefits of control constitute large quantifiable economic value or 14% of equity value on average (Dick and Zingales 2004). Therefore, the private benefits of control is obvious economic gains and plausible motive for economic crimes.
'No-criminal-history' defense (114)	Clean criminal record of white-collar offenders serves as an extenuating factor in sentencing. White-collar criminals describe themselves as law-abiding citizens, admit their mistakes, but deny having committed the crime on purpose. They essentially argue that they are different from conventional street criminals.		
'Acceptance-of-responsibility' defense (108)	As in the United States Sentencing Guideline[12], if a convicted defendant clearly accepts responsibility for his crimes, this also serves as an attenuating factor, allowing judges to give more leniency.		Definitive criteria (even any descriptions of mitigating circumstances) lacks on whether a defendant in question deserves the reduction of illegality under this defense. Thus, this defense is under unbounded judicial discretion.[13]

[12] http://www.ussc.gov/Guidelines/2012_Guidelines/Manual_HTML/3e1_1.htm

[13] In the U.S., the Guideline recounts specific cases where a defendant qualifies under subsection, such as (a) truthfully admitting the conduct comprising the offense(s) of conviction, and truthfully admitting or not falsely denying any additional relevant conduct for which the defendant is accountable under §1B1.3 (Relevant Conduct), (b) voluntary payment of restitution prior to adjudication of guilt; and (c) voluntary resignation from the office or position held during the commission of the offense;

'Top-management' defense (77)	Hired top executives in a business group play subordinate roles in committing crimes. On trial, they tend to argue that they just followed past common management practices as mere employees. Many cases included in our sample occurred before the 1997's financial crisis. Then, few checks and balances constrained dominant shareholders. Prevalent were outdated management practices, such as window dressing and off-the-book accounts. Considering such circumstances, courts lower illegality of hired executives.	The CEO of Doosan Construction Company supplied a controlling shareholder with $12 million off-the-book funds. The CEO invoked the top management defense. The court recognized that he failed to defy untoward orders from a controlling shareholder, but ruled the defendant deserved a suspended prison term.	