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# Department of Justice

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STATEMENT

OF

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DEPUTY ASSISTANT ATTORNEY GENERAL  
CRIMINAL DIVISION

BEFORE

THE

SELECT COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

CONCERNING

THE IMPACT OF CRIME ON SMALL BUSINESS

ON

MAY 29, 1980

68114

JUN 9 1980

## ACQUISITIONS

Mr. Chairman and Members of the Committee --

I am pleased to appear here today as a representative of the Department of Justice to discuss the impact of crime on small business. Joining me is Oliver B. Revell, Deputy Assistant Director of the Criminal Investigative Division, Federal Bureau of Investigation and Henry S. Dogin, Director, Office of Justice Assistance, Research & Statistics, Law Enforcement Assistance Administration, both of whom will have statements.

We at the Department of Justice recognize the important role which this Committee has long played not only in seeking to create a climate in which America's small businesses can prosper but in working with officials at all levels of government to provide improved law enforcement protection for small business enterprises. This hearing today evidences your continued commitment to protecting small business from the ravages of crime and I know I speak for all law enforcement officials in saying that we appreciate your keen interest and strong support.

Small businessmen are concerned about all species of crime, much of which is purely local in nature such as theft, robbery and burglary. While these local offenses rarely fall within the limited jurisdiction of federal law enforcement authorities, the Department of Justice -- through the Law Enforcement Assistance Administration -- has been and continues to be engaged in a number of activities aimed at strengthening local law enforcement efforts; Mr. Dogin will discuss this program in his statement. Of course,

there are numerous federal criminal offenses which often claim small businesses as victims. At the suggestion of Committee staff, our purpose today is to sketch out in broad terms a number of Department activities and initiatives which may be of interest to you. Should the Committee wish to pursue some of these or other issues, perhaps through further hearings, Department representatives will be pleased to work with you and your staff as we know from experience that hearings such as these focus public attention on specific law enforcement problems and heighten awareness of particular patterns of criminal activity.

By way of general initiatives of the Department of Justice, this Department, under Attorneys General Bell and Civiletti, has expanded our commitment to more effective utilization of federal prosecutive and investigative resources and to improved coordination of federal law enforcement with state and local law enforcement efforts. On this latter point, coordination with state and local authorities, the Department in 1977 set as a major goal the creation of Federal-State Law Enforcement Committees in all 50 states. The Federal-State program itself is not new; in fact, it was originally initiated some years ago with the assistance of this Committee. Chairman Alan Bible helped introduce the program by writing the Governors of all the states urging their participation. As the result of renewed efforts by the Department since 1977, and with the assistance of the National Association of Attorneys General and the National District Attorneys Association, we now have Federal-State committees operating in some 45 states.

These Federal-State Law Enforcement Committees provide a valuable mechanism through which federal, state, and local law enforcement officials meet on a regular basis to establish investigative and prosecutive priorities reflecting the needs of the area, exchange information and experience, and resolve the conflicts that inevitably arise as the result of dual jurisdiction over many offenses. In short, these committees improve cooperation and coordination of law enforcement activities, reduce instances of duplication of effort, and help insure that important cases do not "fall between the cracks" as can happen when federal or state officials decline prosecution on the mistaken assumption that the other will pick up the case. Needless to say, we hope that the Committee will continue to support this Federal-State program and will encourage state and local officials to participate. I can assure you that the Department will continue to urge federal officials in every judicial district to participate actively in these committees.

Paralleling the efforts of Federal-State Committees, Attorney General Civiletti earlier this year signed an agreement with the National Association of Attorneys General and the National District Attorneys Association to establish a new Executive Working Group consisting of high-level officials of the Department of Justice and the two associations. The Working Group has held the first two of its regular quarterly meetings to discuss common problems and needs. While we have long worked with these two associations on an informal basis, the press of daily business has too often prevented the regular consultation and discussion

necessary to attain a satisfactory level of coordination and cooperation. We are greatly encouraged by the results of the early meetings and believe the Executive Working Group will help produce the closely coordinated federal, state and local effort that we must have to deal effectively with the national crime problem.

In addition to these efforts to strengthen coordination among law enforcement officials at all levels, the Department has undertaken two important new initiatives to improve the effectiveness of federal law enforcement in dealing with violations of federal criminal law, particularly white-collar crime. As this Committee is aware, white-collar crime often claims small businessmen as its victims and has grown in recent years to the point where white-collar offenses now cause greater economic loss each year than violent crime. In recognition of the seriousness of white-collar crime, the Department has shifted expanded investigative and prosecutorial resources to these complex offenses. Many of the offenses which were in the past the staples of federal criminal law enforcement, such as bank robbery, auto theft and interstate traffic in stolen property, are increasingly being turned over to state and local authorities so that federal law enforcement officials can concentrate on white-collar crime.

First, we are reorganizing our criminal law enforcement efforts. Borrowing from the strike force concept which has increased effectiveness in combatting organized crime by establishing regional organized crime strike forces to coordinate the efforts of the numerous federal, state and local agencies with jurisdiction over various aspects of organized crime activity, the Department of Justice has established Economic Crime Field Units in 16 judicial districts. This new program, initiated by order

of the Attorney General early last year, will ultimately consist of 27 to 30 economic crime units in the offices of United States Attorneys which will be staffed jointly by several Assistant United States Attorneys and one or more economic crime specialists from the Department's Criminal Division. In addition to coordination, these economic crime units will provide training for investigators and prosecutors and will endeavor to increase public awareness of white-collar crime through outreach programs to the public including the business community. We believe the Economic Crime Program will enhance our ability to deal with white collar crime including fraud and other offenses which often victimize small businessmen.

Second, a major effort has been underway within the Department's Criminal Division since late last year to establish national law enforcement priorities within the broad area of white-collar crime and corruption. This project has involved an exhaustive review of a large volume of data and will likely result in the issuance of national white-collar crime priorities next month. Hopefully with national priorities in place we can then begin to focus on local, that is District, priorities. The establishment of detailed priorities will enable us to better coordinate the activities of federal investigators and prosecutors so as to achieve improved efficiency and maximum deterrent effect. I anticipate that priority offenses will include several frequently committed against small businesses, for example, fraud offenses such as advance fee schemes. It will also include other offenses which impact on the small businessman such as public corruption and antitrust violations.

In support of these administrative efforts, legislative initiatives are underway to obtain the weapons needed to achieve a satisfactory deterrent effect from criminal prosecution in the white-collar crime field. The primary legislative vehicle by which we are seeking these weapons is the criminal code reform legislation now pending in both the House and Senate. The Senate bill, S. 1722, contains several provisions which are greatly needed including criminal fine improvements and authorization of injunctive actions to halt ongoing fraud schemes pending criminal proceedings.

Before turning to the investigation and prosecution of specific federal crimes which plague small business, I should note our Cargo Security Program, another initiative established with the assistance of this Committee. Losses from cargo thefts were an estimated \$1 billion in 1979; the victims were primarily motor carriers including small trucking firms. The Department of Justice works closely with the Office of Transportation Security of the Department of Transportation to improve cargo security measures and prosecutes cases involving large thefts from interstate shipments. An important part of the Cargo Security Program is the effort to develop local committees consisting of local carriers and federal, state and local law enforcement authorities, who work together to strengthen cargo security in the major urban centers of the nation. A big problem in the cargo security area has been the lack of cooperation from the transportation industry which is sometimes inclined to view cargo theft as an unavoidable cost of doing business. Of

course, it is our view that crime is not something which should be passively accepted. Rather, I think it has been established beyond dispute that improved security measures and close coordination with law enforcement authorities can dramatically reduce cargo theft as it can other crimes. Knuckling under to crime only serves to create a climate in which crime proliferates. A General Accounting Office study entitled "Promotion of Cargo Security Receives Limited Support" was published in March of this year. The report discusses the cargo security program in some detail. I commend this report to the Committee.

Although small businessmen, like all other citizens, are sometimes victimized by virtually every form of crime, there are several criminal offenses which I would like to discuss briefly as they are often targeted at small businesses. The most common is fraud. As the Chief of the Criminal Division's Fraud Section before assuming my current position, I have had occasion to see a myriad of varieties of fraud. There are several particular species of fraud, however, which seem to recur with alarming frequency with businessmen as their victims. First is investment fraud, the most common variation of which is called the "Ponzi" scheme after one of its most notorious practitioners, Carlos Ponzi. The Ponzi scheme induces its victims to invest their savings through the promise of fantastic dividends. Part of the money solicited is then

returned to victims as "earnings" which leads them to invest more money and to encourage friends and associates to do the same. These schemes grow like a pyramid with investments of late joiners going to pay "earnings" to early participants until such time as the promotor disappears allowing the pyramid to collapse often leaving hundreds of victims in financial ruin. In March of this year, a federal conviction was obtained in California involving a Ponzi scheme that netted its promoters more than \$10 million. That scheme combined a mixture of business and religion. Most Ponzi schemes have at least the ring of authenticity, however, claiming to be based on some highly lucrative new "secret" manufacturing process or traffic in precious metals. Unfortunately, businessmen who fall victim to a Ponzi scheme are sometimes so embarrassed by their own gullibility that they are reluctant to report their losses. Needless to say the Ponzi schemes siphon away capital needed in the small businessman's enterprises.

A second species of fraud, the franchise fraud scheme, claims prospective businessmen as its victims. Through a wide variety of franchise schemes, unscrupulous promoters have bilked thousands of would-be businessmen out of their life savings. An example of this variety of fraud is the case involving Will Bill's Family Restaurants, Inc. There, promoters collected more than \$1 million in deposits toward restaurant franchises. But there were no franchises, no services, and no refunds.

Another common business fraud is the advance fee scheme in which loan brokers charge fees or "points" in return for their promise to extend or secure financing for business projects. Of course, the recent tight money situation has caused advance fee schemes to proliferate as some small businessmen have been desperate for financing to remodel, expand, or invest in new projects. In a major advance fee case set for trial this summer, four individuals who claimed they were descended from a wealthy European family with billions of dollars in personal assets are charged with securing advance fees for business loans which were never made. This scheme apparently operated over a period of seven years in several different States with over a half million dollars in advance fees being collected. But the total loss caused by this one scheme is many times the advance fees solicited. Confident that they have made arrangements for necessary financing, many advance fee scheme victims forge ahead with their business plans only to suffer serious losses when the expected financing does not materialize. It is estimated that one advance fee scheme caused victims to lose a total of \$200 million. I should note that advance fee schemes sometimes utilize the facilities of respectable businesses. Two individuals were recently convicted on the West Coast for soliciting approximately \$80,000 in advance loan fees through an advertisement they placed in one of the nation's most highly respected financial journals. Mr. Revell will touch on some additional aspects of advance fee frauds.

Another business-oriented fraud is the tax shelter scheme. A good example of this scheme is the coal tax shelter case tried earlier this year in New York. In that case, businessmen seeking tax shelters invested more than \$8 million in phony coal mining operations set up as limited partnerships. To add insult to injury, these investments were made after the Internal Revenue Service had changed tax regulations so as to deny tax deductions for such investments.

A major area of fraud activity which impacts both directly and indirectly upon businessmen is insurance fraud. This takes many forms. In one recent federal case, an agent for an insurance company defrauded policyholders out of thousands of dollars by accepting premium payments in exchange for phony insurance policies. More often, it is the insurance company that is the victim of fraud. Of course, such fraud is a serious threat to small insurance companies and drives up insurance rates for honest policyholders. One of the most serious varieties of insurance fraud is the arson-for-profit scheme which has reached epidemic proportions. The Insurance Information Institute reports that fire losses exceeded \$4 billion in 1978 and estimates that arson accounted for about 37% of all building fires. While the number of fires set in connection with arson-for-profit schemes is not known, we believe insurance fraud is the motive behind a high percentage of these fires.

To counter this problem, the Department of Justice, through the Law Enforcement Assistance Administration, commenced a major new program last year directed at arson-for-profit schemes. Mr. Dogin will describe this program in his statement.

Another major area of insurance fraud involves automobile insurance policies. Estimates of various law enforcement agencies are that between 10% and 30% of all vehicles reported stolen are actually fraudulent claims by policyholders who have insured "phantom" vehicles, sold an insured vehicle to individuals specializing in "hot" merchandise, or insured and then disposed of vehicles bought at wrecking yards. The Department has endorsed legislation now pending before the Congress, the Motor Vehicle Theft Prevention Act, S. 1214, which would, we believe, reduce automobile theft and insurance fraud. Again, such fraud is a major problem for small insurance companies and increases insurance rates for all consumers including small businesses.

Of course, there are many other areas of criminal activity which affect small businessmen. Often, organized crime seeks to take control of a particular line of business in an area and will resort to any measure to drive out competition. In a major West Coast organized crime case, a syndicate attempt to control tavern operations in an area produced 35 tavern arsons, a murder, and numerous instances of extortion. In another case, the FBI was instrumental in breaking up a major organized crime ring in New York which had gained control of garbage collection in the Bronx. Mr. Revell touches on that case in his statement.

Public corruption often claims businessmen as victims. One of the largest recent cases involving local corruption has resulted in 25 convictions in Chicago. In those cases, city electrical inspectors received payoffs from electrical contractors in order to approve electrical work done in connection with building or renovation projects. There were also several instances where, in exchange for a payoff, the corrupt city officials would issue work permits to unlicensed contractors. Payoffs ranged from a flat dollar fee to a percentage of the gross from the project. This was all part of a longstanding practice that required electrical contractors to go along with local corruption in order to survive. Of course, this practice also elevated the cost of construction in the area and constituted a serious threat to life and safety as electrical work was judged more on the size of the bribe than on the quality of the installation.

Of course, there are many other areas of federal law enforcement activity of importance to small businesses. Because much property crime is related to narcotics use, our efforts to combat narcotics trafficking affect small businesses. Because very dollar fraudulently taken from federal business assistance programs reduces the aid available to the small business community, legitimate small businesses suffer from fraud against the Small Business Administration. Planned bankruptcies injure small creditors and often result in unfair competition for legitimate small businesses. And the list goes on.

In all of these areas I have mentioned, we have undertaken new initiatives and are developing new measures to combat crime. While we cannot realistically hope to eradicate crime entirely in any of these areas, I believe that we can roll back crime levels. Of course, this requires the cooperation of everyone and, once again, we are grateful for the leadership which this Committee has provided, and is continuing to provide, in combatting those offenses which are of particular concern to small businesses.

**END**