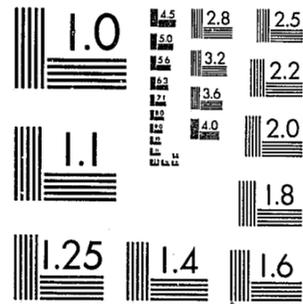


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National Institute of Justice  
United States Department of Justice  
Washington, D. C. 20531

08/04/82

**BANKRUPTCY FRAUD OVERSIGHT**

**HEARINGS**  
BEFORE THE  
SUBCOMMITTEE ON  
IMPROVEMENTS IN JUDICIAL MACHINERY  
OF THE  
COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE  
NINETY-SIXTH CONGRESS  
FIRST AND SECOND SESSIONS  
ON  
BANKRUPTCY FRAUD OVERSIGHT

OCTOBER 17, 18, 1979, AND FEBRUARY 1, 1980

Serial No. 96-52

Printed for the use of the Committee on the Judiciary



U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON: 1980

75975

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(II)

CONTENTS

WEDNESDAY, OCTOBER 17, 1979

STATEMENT

Opening statement of Senator DeConcini..... Page 1

TESTIMONY

Panel on organized crime:  
O'Sullivan, Jeremiah, attorney in charge, Boston field office, organized  
crime section, Department of Justice; Stephen Jigger, attorney,  
Boston field office, and Lionel Avila, special agent, crime investiga-  
tion division, Boston division, Internal Revenue Service..... 2  
Downing, Walter..... 22

PREPARED STATEMENT

Akerman, Nick..... 33

THURSDAY, OCTOBER 18, 1979

STATEMENT

Opening statement of Senator DeConcini..... 35

TESTIMONY

Leevan, Paul, attorney, representing National Association of Credit  
Managers..... 36  
Taylor, Wallace, vice president, Furniture Manufacturers Credit Associa-  
tion..... 48  
Pryor, Ed..... 53  
Bonhiver, Homer, certified public accountant..... 55  
Revell, Oliver, deputy assistant director, Federal Bureau of Investigation..... 64  
Slimovitz, Jack, attorney for trustee, Badger State Cheese Co. bankruptcy  
case, and George M. St. Peter, attorney, Associated Milk Producers, Inc..... 73

PREPARED STATEMENTS

Bonhiver, Homer..... 62  
Leevan, Paul..... 44  
Revell, Oliver..... 69

FRIDAY, FEBRUARY 1, 1980

STATEMENT

Opening statement of Senator DeConcini..... 83

TESTIMONY

Ehmann, Gene, assistant deputy director, Arizona Drug Control District... 85  
Shaefer, William, representing the Office of the Attorney General, State of  
Arizona..... 93  
Smythe, Jack, representing the Federal Bureau of Investigation..... 97

(III)

IV

Corbin, Robert, attorney general, State of Arizona, accompanied by Phil McDonnell, assistant attorney general, special prosecution division-----	103
Hawkins, Michael, U.S. attorney-----	110
Murray, Frank, chief, special operations bureau, Maricopa County attorney's office-----	119
Kimmel, Captain Jerry, organized crime bureau, Phoenix Police Department-----	125
Bearentz, Detective John, organized crime bureau, Phoenix Police Department-----	130
Rhiel, Detective Terry, Phoenix Police Department-----	133
McCracken, Detective Lonzo, Phoenix Police Department-----	135
Madison, Sergeant James, Phoenix Police Department-----	137
Duecy, Charles, attorney, Scottsdale, Arizona-----	141
Lebowitz, Ron, attorney, Phoenix, Arizona-----	149
Beene, Prof. Leon, and Frances Brunner, representing Montezuma Vested Rights, Inc-----	158
PREPARED STATEMENTS	
Brunner, Frances-----	167
Duecy, Charles-----	146
Hawkins, Michael-----	115

**BANKRUPTCY FRAUD OVERSIGHT**

WEDNESDAY, OCTOBER 17, 1979

U.S. SENATE,  
SUBCOMMITTEE ON IMPROVEMENTS  
IN JUDICIAL MACHINERY,  
COMMITTEE ON THE JUDICIARY,  
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 1202 Dirksen Senate Office Building, Senator Dennis DeConcini (subcommittee chairman) presiding.

Present: Senator DeConcini.

Staff present: Romano Romani, staff director; Robert E. Feidler, counsel; Pamela I. Phillips, chief clerk; Sandra Walsh, secretary; Kevin O'Malley, staff assistant; and William Christensen, investigator.

**OPENING STATEMENT OF SENATOR DeCONCINI**

Senator DeCONCINI. Good morning.

Today, the Subcommittee on Improvements in Judicial Machinery commences hearings on the general subject of bankruptcy fraud. The impetus for these hearings occurred nearly 2 years ago when then Attorney General Griffin Bell and Commissioner Philip Loomis of the Securities and Exchange Commission, at testimony they presented to this subcommittee on the proposed Bankruptcy Reform Act, since enacted as Public Law 598, encouraged the subcommittee to look into the general area of bankruptcy fraud. Both gentlemen commented that it had been their experience that there was a definite connection between organized crime and bankruptcy fraud and that it should receive congressional attention. The purpose of these hearings is to do just that: To educate the Congress as to the scope of the problem; familiarize ourselves with the patterns of criminal activity leading to the bankruptcy process being abused; and to solicit suggestions as to how the problem of bankruptcy fraud can be identified and stopped.

It has been this Senator's experience in the criminal justice area that organized crime is involved in a multitude of various activities, ranging from the Ponces games to bankruptcy and also to severity of drugs and contractual homicides. It is hoped that this will be the beginning of a series of hearings that will bring out to the public and to the Congress the significance of the involvement of organized crime in our legitimate society in activities, including the business community.

We are particularly pleased to have a set of expert witnesses here today who will share with us testimony and some specifics of their historical investigations into this area of bankruptcy and fraud. Our panel this morning is composed of Jeremiah O'Sullivan, attorney

in charge of the Boston Field Office of the Organized Crime Section of the Department of Justice, known as strike force; Stephen Jigger, attorney with the Boston Field Office of the Organized Crime Section, Department of Justice; and Lionel Avila, special agent with Crime Investigation Division of the Boston Division of the Internal Revenue Service.

I would first like to have the record show that the Boston strike force has been extremely effective and involved in numerous investigations that I know of not only by title but by reputation. The Justice Department has demonstrated that there can be effective law enforcement in the area of organized crime, and I compliment you, Mr. O'Sullivan, and your colleagues, for the effort that you have put forth.

Your statement has been submitted, and if you will lead off, Mr. O'Sullivan.

**PANEL ON ORGANIZED CRIME:**

**STATEMENTS OF JEREMIAH O'SULLIVAN, ATTORNEY IN CHARGE, BOSTON FIELD OFFICE, ORGANIZED CRIME SECTION, DEPARTMENT OF JUSTICE; STEPHEN JIGGER, ATTORNEY, BOSTON FIELD OFFICE, ORGANIZED CRIME SECTION, DEPARTMENT OF JUSTICE; AND LIONEL AVILA, SPECIAL AGENT, CRIME INVESTIGATION DIVISION, BOSTON DIVISION, INTERNAL REVENUE SERVICE**

Mr. O'SULLIVAN. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to appear here today to discuss the problem of bankruptcy fraud.

In the past 2 years, the Boston Field Office of the Organized Crime Section of the Department of Justice, and the Federal Bureau of Investigation, the Internal Revenue Service and the Postal Inspection Service, which work with my office have investigated and prosecuted a series of planned bankruptcies, known as "bustouts," in Massachusetts and Rhode Island. These prosecutions have resulted in the conviction of approximately 20 people for bankruptcy fraud and related crimes.

Two of these bankruptcy frauds alone obtained in excess of \$1 million each in merchandise from various suppliers. In addition, individuals now cooperating with my office who participated in the operation of a number of bustout businesses have identified 13 "bustouts" which defrauded suppliers of in excess of \$2 million. Investigation to date has identified another 17 businesses operated in a similar manner in the Commonwealth of Massachusetts. Information obtained from confidential informants of the Federal Bureau of Investigation also indicates that these types of scams continue to be operated at present, as new businesses are taken over or established.

These planned bankruptcies are referred to as "bustouts." In essence, a bustout entails the operation of a business which after establishing a credit rating, through various means, orders mass quantities of merchandise from suppliers throughout the United States with no intention to pay. This merchandise is then disposed of for cash at under its manufacturer's invoice price. These businesses, after

their credit has been exhausted, are either abandoned or placed into bankruptcy.

The active period of fraudulent operation is normally 6 months or less. If the businesses go into bankruptcy, the return to the creditors can be measured in pennies on the dollar. In many instances the extent of the fraud is never discovered because vendors, seeing the futility of recovery, do not file claims. It was also learned during the investigations that we have conducted that during certain periods of maximum activity by individuals operating these bustouts that credit was unobtainable by legitimate small businesses in the Greater Boston area.

The investigations also revealed a significant involvement by members and associates of organized crime. The major distribution outlets which purchase the bustout merchandise are controlled by organized crime figures. In addition, they also operate some of these bustouts themselves. Where independent operators have been active in operating bustout businesses, a pattern of extortion surfaced where the operators were threatened and forced to sell to organized crime-controlled outlets. In addition, a 10-percent protection fee was extorted from the store operators on all sales for protection. When these payments were not made, physical beatings resulted.

I compliment you, Mr. Chairman, and your staff, for having helped to solve one of the most difficult problems that until very recently a prosecutor had to overcome in prosecuting bankruptcy fraud; that is, the problem of tainted evidence that always arose because the bankrupt was automatically immunized when he testified in a bankruptcy proceeding. Recent revisions of the Bankruptcy Act have removed this problem. Immunity no longer automatically attaches to the testimony of a bankrupt; rather it is only conferred with the participation and approval of the U.S. Attorney and the Department of Justice.

There are several problem areas in the investigation and prosecution of bankruptcy frauds which I want to raise for the committee's consideration. The first problem is the very limited investigations that are now carried out by bankruptcy court officials to determine if there is fraud involved in a particular bankruptcy. At present, it appears that when a trustee is faced with a bankruptcy in which the bulk of the assets of the business have disappeared and the bankrupt falsely claims that his records have been destroyed by fire or some other calamity, little if anything, is done to try to reconstruct the bankrupt's records or to locate the missing assets.

In many such situations, the creditors give up rather than expend more moneys to trace down the assets and the records. While the trustee has the power to appoint an accountant to help him locate the missing assets and records, it has been the experience of my office that the trustee will rarely do so, especially if the creditors object to spending the remaining moneys of the bankrupt business to hire an accountant.

This committee should consider whether legislation could be enacted which would mandate that an investigative accountant be hired in any bankruptcy in which fraud is suspected. It may be possible to construct a statutory formula defining those cases which would fit

this category. For instance, Congress could mandate that an investigative accountant be hired by the trustee in all bankruptcies in which the potential losses exceed a certain amount and in which the records of the bankrupt are either missing or substantially incomplete. Public moneys would have to be appropriated to hire such accountants. These funds for investigation would be recovered from the bankrupt in those cases where fraud was proven.

This committee should also consider prosecutive problems relating to section 152 of title 18 which makes it a criminal offense to conceal assets in contemplation of a bankruptcy proceeding. While courts have held that no actual bankruptcy petition need be filed to be found guilty under section 152, the case law is less clear on what actions defendants must take to violate paragraph 7 of section 152 which pertains to concealing assets in contemplation of a bankruptcy proceeding. This phrase has never been fully explained by a court. In contemplation of bankruptcy has been defined by the courts only in the civil context of discussing former section 60 of the Bankruptcy Act dealing with unlawful preferences. But it appears that the courts will require at least very strong circumstantial evidence that a defendant who effected a fraudulent transfer of assets prior to a formal bankruptcy did so with intent to defeat the bankruptcy laws. If this is so held by the courts then it will be difficult to prosecute an individual who participates in a bustout but who never intends to file a voluntary bankruptcy petition and who is petitioned into involuntary bankruptcy by his defrauded creditors. The problem is magnified in multidefendant corporate bankruptcy frauds, where, absent insider testimony as to intent, it is extremely difficult to prove that the defendants' actions were taken in contemplation of a bankruptcy proceeding.

Finally, in connection with amending section 152 of title 18 which became effective on October 1, 1979, the Congress amended section 1961 of title 18, the racketeer influenced and corrupt organizations statute. This amendment to section 1961 substituted the language "fraud connected with a case under title 11" for the former language which simply stated "bankruptcy fraud."

The problem with this revision of section 196 may be that the courts may interpret the amended section 1961 to require that in order for bankruptcy fraud to be a predicate crime under RICO statute that the fraud has to occur in connection with bankruptcy proceedings under the recently amended title 11 and that therefore bankruptcy fraud which occurred prior to October 1, 1979, cannot be a predicate crime under RICO.

I think an amendment to the statute has caused substantial problems with RICO statutes as they relate to bankruptcy fraud.

I will entertain any questions that the chairman or anyone else has.

I have with me Mr. Jigger of my staff, who participated in the prosecution on a number of these and continues to participate in a number of prosecutions under bankruptcy fraud. and Mr. Avila of IRS who did work, accounting work, and can describe some of the problems in reconstructing records and various accounting problems that are faced in this kind of an investigation.

Senator DECONCINI. Mr. O'Sullivan, thank you very much.

We really appreciate your bringing to our attention the relation of the Bankruptcy Act and the RICO statutes, and we are going to pursue your suggestion in the technical amendments and corrections we are going to make to the Bankruptcy Act this year. Hopefully we can work with you a little bit more to be sure we are getting to the particular problem that you so eloquently addressed this morning.

In your opening remarks you stated that your office investigated and prosecuted a series of planned bankruptcies known as bustouts. Could you amplify on what you believe is the magnitude of the bankruptcy frauds? What is your best guess as to how many such incidents occur in your particular region, and do you think it is only the Northeast that is plagued with this particular problem, or do you have any reason to believe that it is nationwide?

Mr. O'SULLIVAN. I will address the latter part of the question first, Mr. Chairman.

I do not have a national experience in other sections of the country with respect to particular prosecutions, but with respect to the prosecutions that my office has undertaken, we have now communications between the various defendants prior to their being indicted, of course, in individuals and other sections of the country specifically New York-New Jersey area, and the Atlanta, Ga., area, with respect to providing false credit references for each other, to the transfer of merchandise and other kinds of things, so I would believe that the problem is happening in other sections of the country, although I think that I would have to qualify that by saying that that is the extent of my experience in that particular area.

Senator DECONCINI. Along that line, in your discussions or meetings with your colleagues in the Justice Department around the country, did you find this subject discussed or of any great interest?

Mr. O'SULLIVAN. I find it is discussed very generally today, Mr. Chairman, especially in connection with the reordering of priorities that Attorney General Bell, former Attorney General Bell, and now present Attorney General Civiletti have imposed upon the criminal division, that is, to get involved in white collar crime, specifically economic crime, crime that impacts across a broad spectrum of the community, rather than the more—for lack of a better name—mundane crime that we have perhaps prosecuted in the past.

So this particular area is now being for the first time examined in a systematic manner, and I would suggest, Mr. Chairman, that that examination will probably fill a much larger problem than we are even aware of at the present time.

Senator DECONCINI. Can you now refer back to the first part of my question, as to what you believe the magnitude is in the Northeast and your area, as to the numbers or the amounts involved?

Mr. O'SULLIVAN. Mr. Chairman, with one caveat, my specific mandate is to investigate the connection of organized crime as it relates to these various matters, so I have a much more discreet area of inquiry than the normal broad spectrum of bankruptcy fraud.

Within that particular area, sir, I think I've indicated that we talked about a prosecution of approximately 20 bankruptcy frauds. We have got a number of others under investigation right now. I've not seen

any of them in terms of the amount of money that basically goes under a quarter of a million dollars.

We are essentially talking about opening corner stores, very, very limited kinds of commercial establishments, which then proceed in the course of up to 6 months to garner someplace between \$1½ million and \$1 million a crack. We do not have a bottom line figure—

Senator DECONCINI. Is that the credit that has been extended?

Mr. O'SULLIVAN. That is the invoice price, and merchandise, which the creditors are out at the end of that very short period of time, Mr. Chairman. We again, I would say, are only beginning to look at this particular problem. We have only looked at it over the last 2 years, essentially.

Attorney General Bell, as I said, has imposed these particular priorities, and I think they have caused a reworking of the priorities, not only in the Department, but in the investigative agencies, and we are now finding the investigative agencies looking at this problem.

It is a long way of saying, Mr. Chairman, that I don't have particular figures for the dimension of the problem, but my impression is that it is a substantial problem, a problem that the bankruptcy courts have not yet addressed.

I took the opportunity to—I used to be at the U.S. attorney's office—to check the figures with respect to referrals by the bankruptcy court over the last 4 or 5 years in the district of Massachusetts for potential bankruptcy fraud.

And according to the assistant who handles that category there have been less than five referrals over that particular period of time. So my impression is and his impression more particularly is that the bankruptcy courts have not addressed this problem and have very rarely referred cases for fraud.

The underlying policy being, because of the commercial system that is involved here, that we are to discharge people or move the people through the system as quickly as we can.

So I think it is a problem that is just now being addressed, Mr. Chairman.

Senator DECONCINI. You mentioned, and without getting any more specific about the cases that you have been involved in, you mentioned about 20 active cases, is that correct?

Mr. O'SULLIVAN. Yes, Mr. Chairman.

Senator DECONCINI. And you make some reference to a quarter of a million dollars being involved, and I realize that is a guesstimate, perhaps, in these cases. You have been involved in this effort for approximately 2 years.

Mr. O'SULLIVAN. Two years: a little bit more, 2½ years.

Senator DECONCINI. And what convictions have you achieved?

Mr. O'SULLIVAN. We have achieved a substantial number of convictions. I think it is 20 individuals so far. We had three pleas in a case yesterday that is currently on trial. We have got another case starting next week. We are very actively involved in the middle of this right now. We have close to 25 convictions right now.

Senator DECONCINI. What is the general number of defendants that you are talking about in those 20 cases? Can you give me some kind of idea about how many individuals we may be talking about?

Mr. O'SULLIVAN. It varies from case to case, but we are talking about a constellation between codefendants, unindicted coconspirators of about 50 to 60 people right now. What we have tried to do is, given our prosecutive resources and so on, is just to pick off the most important cases and not to get into the bankruptcy fraud area in a sense that we are the solution to all bankruptcy frauds.

I find that a number of bankruptcy fraud lawyers, once they understand we are into it, want us to get into other areas, but these areas are not areas where we can detect involvement of organized crime. They seem to be traditional business crimes, independent operators, and we have to resist that temptation, given our resources.

Senator DECONCINI. Would you say, based on your charge to deal with organized crime in its relation to bankruptcy fraud the proverbial iceberg, would you say you have just scratched the surface, or do you believe that you are well into it?

Mr. O'SULLIVAN. I think that we are just scratching the surface, but I do not know the level of our penetration yet. I think we are into it in a substantial way. I think that once you get into it you start developing informants and witnesses, and it starts to snowball. The hardest thing was getting into it initially, and basically reallocating our resources and learning how to do this kind of thing—I mean to just get through the statutory scheme and to learn how bankruptcy court operates and learn how trustees operate. I think I could back up for 1 second and point out that one of the immense helps that this committee or the Congress has given to the prosecutive arm of the Government is the change in the immunity statute. In the past, when you would attempt to get involved in bankruptcy fraud, you would immediately find out that the bankrupt had been immunized, and as the chairman, I am sure, is aware, once somebody is immunized, the burden is then on the Government to show that it derived all its evidence independent of the immunized testimony. That is practically an insurmountable object, and so any time anybody wanted to look at bankruptcy fraud, they were immediately faced with this problem. So when allocating resources, most times people walked away from it because the payoff at the other end of the line, making a judgment early on, would be that the case would probably be dismissed because the evidence was tainted.

So, I think that just the revision in the immunity statute is going to make it easy to investigate this type of crime and is going to generate a lot more cases.

Senator DECONCINI. Mr. Jigger, maybe you could respond to this next question. What exactly is the role of organized crime in the bankruptcy fraud? Do they actually participate in the bustout of the companies, or are they restricted to the fencing of the stolen properties, or is it a mesh of both of these efforts?

Mr. JIGGER. Yes, Mr. Chairman. Our experience has shown that organized crime is involved at all levels. They will operate these scams. They will be the main outlets for scams operated by others. They will handle the major distribution network for this merchandise. They will use intimidation or extortion to insure that the merchandise is sold, by their approved outlets, and they will collect fees for protection for the operation of individuals who are selling merchandise to them. So I think their involvement has been on all levels.

Senator DECONCINI. Going back a little bit, in your efforts to decide what cases to take on in organized crime, what is your definition, Mr. O'Sullivan, or Mr. Jigger, or the two of you, of what you perceive organized crime to be?

Mr. O'SULLIVAN. It is almost like it is the Justice of the Supreme Court says when he—I know it when I see it.

The definition—I think the best working definition is the definition that Ralph Salerno, a former New York police officer gave, which is a continuing criminal conspiracy utilizing force and violence to obtain the ends, the ends being power and money.

There are some people who would then say that that definition could apply to the Hell's Angels if they get involved in the distribution of drugs. We have attempted, because of the limited resources of our office, to define organized crime even more strictly than the working definition that I gave by looking at the traditional La Cosa Nostra (LCN) Mafia group in this country as the primary focus of our activity, and secondarily any group that interfaces with that group in a direct manner and reacts for it.

For instance, in Boston, traditionally the LCN faction has numerically not been that large, but they have always been able to manipulate one of the principal Irish independent gangs who have done most of their daily work for them. So we have focused a lot of attention on that independent gang because of its direct relationship with the LCN. That is our basic focus, sir, in that traditional organized crime LCN activity.

Senator DECONCINI. Based on that information, can I gather that you think the traditional LCN, the organized crime individuals and organizations, are directing this type of effort?

Mr. O'SULLIVAN. Directing in the sense that the principal lieutenants, or at least two of the principal lieutenants of the LCN leader in Boston, were actively involved in operating these businesses and we are meeting with him to discuss this on a regular basis, yes. It was to the principal organized LCN figure in Boston, it was another enterprise in which he had subordinates operating in which he received a fee. Yes, that is what I believe, and I think we have substantial knowledge to support that belief.

Senator DECONCINI. The particular individuals that you are dealing with, La Cosa Nostra, the LCN, are they of national prominence, in your judgment, or are they primarily of local prominence?

Mr. O'SULLIVAN. They are of national prominence, Mr. Chairman. We see on a regular basis interaction between the LCN family in New England and New York, figures from New York coming up, down to New York. We have informant information that there is that kind of interaction, going back to a Mafia family war in the early sixties in New York, that was mediated by the LCN in Boston, in New England.

We see New England family, while being a relatively small family in term of numbers, have a significant impact in the New York area, and in Las Vegas, specifically.

Senator DECONCINI. It is not just regional?

Mr. O'SULLIVAN. It is not a regional problem at all, no, sir.

Senator DECONCINI. You touched on the dollar amount in your area. Do you have any knowledge, Mr. O'Sullivan, or Mr. Jigger, of

what involvement Justice is doing in other areas like New York or in the Northeast area? Do you have any interplay with those strike forces or the Justice Department or the district attorney working in bankruptcy or organized crime fraud?

Mr. O'SULLIVAN. The interplay is not as systematic a practice as it should be, Mr. Chairman, as we are so busy on a day-to-day basis. We do have a strike force—chief meetings several times a year—and we do have regular conferences, and you have here today an attorney from the strike force in the southern district who will be testifying as to theater case and other bankruptcy fraud cases.

I see the primary focus so far, at least it is my impression, and this is an impression I speak for myself, my impression is to the commitment of resources into bankruptcy fraud. It used to be in the eastern part of the United States, the East and Northeast region. I do not see concurrent commitment of resources in the Midwest and West. I could be proven wrong in that, but that is my impression at this point in time.

Senator DECONCINI. Mr. Jigger, can you give us any more details on the individuals involved that head up the LCN involvement in the Boston area? Can you disclose the names of any of those people or any individual cases that have already been prosecuted?

Mr. JIGGER. I will let Mr. O'Sullivan answer that.

Mr. O'SULLIVAN. I would like to handle that.

The problem with that at this particular point is the fact that we have currently cases on trial involving some of these individuals, and there is a very strong opinion in the first circuit with respect to generation of publicity in cases that are currently on trial.

I have no objection in executive session, or at a later date—and after we finish up this series of cases—to addressing that question, but I prefer at this time not to get into the particular names and even in the cases where there have been convictions, some of these defendants have cases pending, as recently as a jury impaneled yesterday.

Senator DECONCINI. Can you give us a hypothetical or an actual case without using names, as to how one of these schemes is put together, without disclosing or disrupting your prosecutorial efforts?

Mr. JIGGER. Yes, Mr. Chairman.

Each bustout, while similar in its objective, uses different techniques through its structure and also through the sophistication of the individuals that are operating it. In general, most of these scams commence with either takeover of existing legitimate business or establishment of a new business.

Invariably, these businesses are in corporate form. The operators are aware that the corporate form can be used by them as a shield to protect their privacy and personal assets from any liability. Once such business is either taken over or commenced, the first order of priority for such a business is to obtain credit, because credit is the lifeblood of this type of scheme. This is done in a number of ways.

If an existing business is taken over, the credit of that business is utilized with the creditors not being—

Senator DECONCINI. Excuse me. Would you explain to me how they take over the business, the various ways?

Mr. JIGGER. Yes, Mr. Chairman.

There are several manners: It may be a purchase of a small business, it may be the takeover of the business because of individuals having become financially unable to carry forward because of indebtedness, because of gambling or loan sharking. There are a number of ways that a business may be assumed: There may have been a death by the principal operator, and an individual involved with organized crime manages to take over the business in that manner.

If a business is taken over in that manner or if a new business is commenced, many times that business will be operated for a period of time during which the bills are paid. I think it is important to note that while these businesses from their very inception contemplate the operation of the scam, the scam may not commence immediately. There are certain prerequisites that may be followed to develop the circumstances sufficiently so that the fraud may be maximized. This may include paying companies for a period of time, paying them for several reasons.

First of all, companies may be paid so as to set them up for a larger order later on. Several orders may be paid to get that third or fourth order, which is far greater magnitude.

Second, companies may be paid so as to use them as legitimate credit references by establishing a track record, if you will, for this business and then a major corporation could be utilized when merchandise is ordered from suppliers across the country.

In addition, a company will utilize a phony financial statement greatly inflating the assets of the business. In addition, attempts will be made to obtain a D. & B. rating. These businesses also use bank references very heavily. It is standard operating procedure in these scams to have what is known as a four-figure bank balance so that when a creditor contacts the bank, the bank will say, yes, this company maintains an account with us and that account is generally in the four-figure range.

Many times the banks will give no further information than that, so the company will assume that there is a stable company that maintains a substantial account which would allow it to pay for any merchandise which is obtained.

In addition, many of these scams are interrelated. If you have independent operators, they will assist one another. They will exchange fraudulent credit references among themselves.

One company will say, I have been doing business with him for a lengthy period of time. His credit is good; fine account.

In exchange, the other bustout operator will supply the same information.

In addition, we have also found instances where false credit references have been supplied by the actual purchaser. The organized crime-connected outlets will supply companies that have had no connection with these businesses whatsoever, but companies that will provide excellent credit references when a supplier contacts them in assessing whether or not merchandise should be shipped on credit.

Senator DECONCINI. These are what appear to be legitimate companies, but controlled by organized criminal activity.

Mr. JIGGER. That is correct, Mr. Chairman. All of this is done for the purpose of obtaining merchandise. Merchandise can be obtained in a number of manners by these businesses.

What their intent is is to order large quantities of this merchandise from suppliers across the United States. This can be done in a number of ways: Mail or wire, telephone orders may be placed from catalogs, trade shows are very common vehicles where a representative of the business will go to a trade show of manufacturers, either Chicago or New York, and order large quantities of merchandise; sales representatives, locally, may be contacted. But there are several policies that are followed by these businesses when merchandise is ordered. There is an emphasis on ordering from out-of-State businesses.

This is done so as to assist them in avoiding collection. If a company is out of State, the credit check seems to be less rigorous, the likelihood of recovery by coming in and taking their merchandise out of the store is less likely, so there is an emphasis on ordering from companies beyond the jurisdiction.

Second, the initial orders may be small, because the operators are aware of the general credit practices that are followed by companies.

In addition, they are very astute businessmen in many circumstances and they will shop for best credit terms available.

This is done for two reasons. First of all, to make the company appear legitimate and; second, during the commencement of the fraud it is vital for them to be able to have the business in operation as long as possible so that at the initial phases they will be ordering from companies or industries that they know to be traditionally givers of lengthy credit terms. Toward the end of the business where it is close to its demise, they will order from everyone, anything on any credit terms, because they plan to have the business closed very shortly.

We also found that once an order comes in, very commonly they will immediately reorder the merchandise, telling the supplying company that the merchandise is the greatest thing they have ever seen. They can't move it fast enough, they want more. Letting the company feel that they have a very hot product. And, finally, we found instances where there was complicity between the operators of the bustout stores and sales representatives. Specifically manufacturers' representatives who would be working on a commission basis who would be paid based upon merchandise shipped and not necessarily paid on eventual payment. We found instances where sales "reps" would write orders, knowing full well that this merchandise would never be paid for, but were assisting the operation in that manner. That is basically how the merchandise can be obtained.

The next question would be how can it be disposed. When a business such as these obtains a quarter of a million dollars' worth of merchandise, they can't eat it, they can't put it in the bank. They have to do something with it. Now if it is a retail store bustout where a fraudulent storefront is used as a front for the scam, there is the possibility of moving small quantities of merchandise through their retail operation. In addition, merchandise can be moved at flea markets or sold to street vendors, so-called hustlers, the kind of individuals that sell watches or radios from the trunk of a car. Also, sales may be made by bustout operators to small businesses, such as drugstores, or small retail outlets.

However, these things for the most part can only be done where principals are willing to be connected with the business or where the possibility of paper trail is not something which concerns them and

There are several manners: It may be a purchase of a small business, it may be the takeover of the business because of individuals having become financially unable to carry forward because of indebtedness, because of gambling or loan sharking. There are a number of ways that a business may be assumed: There may have been a death by the principal operator, and an individual involved with organized crime manages to take over the business in that manner.

If a business is taken over in that manner or if a new business is commenced, many times that business will be operated for a period of time during which the bills are paid. I think it is important to note that while these businesses from their very inception contemplate the operation of the scam, the scam may not commence immediately. There are certain prerequisites that may be followed to develop the circumstances sufficiently so that the fraud may be maximized. This may include paying companies for a period of time, paying them for several reasons.

First of all, companies may be paid so as to set them up for a larger order later on. Several orders may be paid to get that third or fourth order, which is far greater magnitude.

Second, companies may be paid so as to use them as legitimate credit references by establishing a track record, if you will, for this business and then a major corporation could be utilized when merchandise is ordered from suppliers across the country.

In addition, a company will utilize a phony financial statement greatly inflating the assets of the business. In addition, attempts will be made to obtain a D. & B. rating. These businesses also use bank references very heavily. It is standard operating procedure in these scams to have what is known as a four-figure bank balance so that when a creditor contacts the bank, the bank will say, yes, this company maintains an account with us and that account is generally in the four-figure range.

Many times the banks will give no further information than that, so the company will assume that there is a stable company that maintains a substantial account which would allow it to pay for any merchandise which is obtained.

In addition, many of these scams are interrelated. If you have independent operators, they will assist one another. They will exchange fraudulent credit references among themselves.

One company will say, I have been doing business with him for a lengthy period of time. His credit is good; fine account.

In exchange, the other bustout operator will supply the same information.

In addition, we have also found instances where false credit references have been supplied by the actual purchaser. The organized crime-connected outlets will supply companies that have had no connection with these businesses whatsoever, but companies that will provide excellent credit references when a supplier contacts them in assessing whether or not merchandise should be shipped on credit.

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However, these things for the most part can only be done where principals are willing to be connected with the business or where the possibility of paper trail is not something which concerns them and

can only be used to move small amounts of merchandise. If a major scam bankruptcy fraud is to be operated, given the short duration of this type of scam, an outlet which can move mass quantities of merchandise is required. We have found that those outlets are traditionally the outlets which are organized, controlled by organized crime figures which deal in stolen goods.

The vast quantities of bustout merchandise which is obtained by these scams moves through these outlets, and it moves on the following terms. It is sold at 50 percent of its invoice value for cash, no records are maintained of the transfer, and the boxes and any other documents such as the original invoices are stripped of all connection with the bustout business. In other words, a shipping label will be physically cut from the box.

If there are circumstances where, because of the method of operation of the bustout, some records are to be maintained any checks that are received are not deposited in the account of the business but rather are converted to cash through various means. In addition, if an invoice is provided, the detail on the invoice as to unit cost, as to exactly what the merchandise is, is normally so sketchy that it would make tracing that merchandise virtually impossible. In addition, merchandise can be moved through what could be described as laundering outlets, intermediate businesses which make this merchandise one or two steps removed from the bustout store, which are then free to sell large quantities to major outlets, such as discount chains.

All of this leads to creation of a large amount of debt in the business and results in its eventual closing through various means.

Senator DECONCINI. How big are the outlets in your opinion, Mr. Jigger? Are they multimillion dollar operations on an annual basis?

Mr. JIGGER. Yes, Mr. Chairman.

Senator DECONCINI. How many do you think we are talking about? Are we talking about a handful or hundreds or dozens, or do you have any estimate?

Mr. JIGGER. Mr. Chairman, in the context of our investigation I can only speak as to what we have seen in the Greater Boston area.

Senator DECONCINI. How many have you seen there?

Mr. JIGGER. We have seen approximately four or five given that we were following a pinnacle approach, we found that there were several groups which would use a single or two outlets at a time. This is not to mean that the outlets aren't constantly changed. But generally we found three or four major groups handling this merchandise within the bankruptcy scams that we have uncovered at this point. That is not to say there aren't more.

Senator DECONCINI. Has it been your experience that the pattern of directorship and ownership, if you want to call it that, of the outlet often are tied to the ownership of the business that has been taken over? Is there a direct relationship of those, or are they different groups? Is the outlet organized crime as well?

Mr. JIGGER. We have found both circumstances. Mr. Chairman.

Senator DECONCINI. When you find out that the outlet is tied to organized crime, is it in the same family, the same organization as the bustout?

Mr. JIGGER. Yes, Mr. Chairman.

Senator DECONCINI. Along that line you are talking about, you indicate this amounts to millions of dollars. Is a big percentage of the merchandise, in your judgment, shipped away from the local vicinity, or is, say, Boston big enough to absorb the goods so they don't have to worry about that?

Mr. JIGGER. It really depends upon the pattern of operation of the outlet. We found both instances. We found instances where large quantities were distributed within the New England area. We also found instances where it was shipped beyond New England. It really depends upon the size of the outlet which is being used and its pattern of distribution.

Senator DECONCINI. Do you have any evidence or information as to how far it is shipped away when the outlet gets involved? Is it shipped to many States, hundreds of miles, or is it just in the vicinity or does it make any difference as to what the merchandise may be?

Mr. JIGGER. We have found, with the outlets we have examined, most of the distribution would have been on the eastern seaboard. However, we do find that while the distribution may be limited, the merchandise, which is acquired, is acquired from all portions of the country.

I think it is significant to note that during one portion of the investigation we found that one company in California was defrauded of in excess of \$150,000 worth of merchandise, by four or five of these stores.

Senator DECONCINI. The intermediate outlet that you talk about, I kind of gather from your statement that it is more legitimate, perhaps not owned and operated by organized crime; is that a fair interpretation?

Mr. JIGGER. The further you go in the line of distribution the greater the appearance of legitimacy—

Senator DECONCINI. Only appearance?

Mr. JIGGER. Only appearance. We found that the distribution outlets were controlled by the major figures.

Senator DECONCINI. When these outlets finally legitimize the merchandise—and I take it from your statement sometimes they finally sell it to a national chain of some kind—what kind of problems do those chains run into? They must be sophisticated enough to know if they are buying below wholesale, there is something tainted about it? How do those chains, if you know, deal with the problem of guarantees and delivery and damage?

Mr. JIGGER. I don't have any firsthand knowledge of how the chains handle it. It should be noted many of the items that are obtained are small consumer items, the kinds of items that would not have serial numbers or would have the kind of warranty protection which would enable them to be traded back to their source. So that problem does not confront a major chain.

Senator DECONCINI. Do you find any complacency on the part of the legitimate chainstores that might ultimately be a purchaser from the outlets in just buying them without more investigation on their own part?

Mr. JIGGER. I would think there is very little investigation on the smaller business level. They are clearly aware of the type of merchandise, and the questions are not asked.

On the larger level, it is difficult to say. There are many instances where merchandise is closed out or manufacturers overstock, where there may be a legitimate reason for sale at under manufacturer's invoice price. So, to say that a major chain would definitely know what the source of the merchandise is is really something that it is impossible to say, without speaking with an actual buyer.

Senator DECONCINI. What kind of merchandise? Can you give us a category? Is it household appliances, televisions or things like that, more than some other areas like tires?

Mr. JIGGER. Yes, Mr. Chairman, consumer goods, goods which can be moved readily, televisions, stereos, radios, electric can openers, electrical calculators were heavily hit during the early period of 1974 to 1976, when calculators were just coming onto the market. Depending upon the season, toys may be a large item, sporting goods; it really depends upon the outlet that the individual operator has, and whether or not they will ship it on credit. If merchandise is to be shipped on credit and an operator feels he will get rid of it, he will order anything.

Senator DECONCINI. Do you find it in the area of jewelry?

Mr. JIGGER. We have found instances where there have been jewelry scams as well, Mr. Chairman.

Senator DECONCINI. What about liquor? It is not traditionally sold on credit, is it?

Mr. JIGGER. Not to my knowledge. We have taken no instances where liquor was obtained in this manner.

Senator DECONCINI. In the area that you are involved in, the Boston-New England area, do you find, as a result of being involved in this, a reluctance of legitimate wholesalers to extend credit to small business?

Mr. JIGGER. Absolutely, Mr. Chairman. At one period of time in a section of Massachusetts, we were informed that businesses would not ship on credit, because they were so aware of the existence of the large number of scams operating in that section, and they had been burned so many times that they were reluctant to ship on credit at all.

Senator DECONCINI. Was this prior to your involvement in opening up the office?

Mr. JIGGER. Prior to the commencement of our investigation.

Senator DECONCINI. Your investigation. Has that changed at all, to your knowledge?

Mr. JIGGER. I think it has changed. I think what we see is a cyclical situation in that if a large number of fraudulent businesses have been operating or companies have been hit from a certain area, they tend to tighten their credit requirements.

However, given the need to ship merchandise and the approach of the Christmas season, there is a general loosening of credit after a period of time.

Senator DECONCINI. Mr. Avila, let me ask a question as to the involvement of Internal Revenue. You are assigned to the strike force to assist them in tracking records?

Mr. AVILA. That is correct, Mr. Chairman. I was assigned to assist in helping create various—compiling records is what it basically came down to. The number of creditors that were hit when we finally cir-

cularized them, sent letters out and received their responses to invoices, bills of lading, and documents were in the high six figures. It filled file cabinets.

They used me to, one, take this information, put it on work papers, get it down to a reasonable summary sheet so that we could possibly work with them.

They also used me to secure various intent items, analyzing, one, the bank statements, bank records of the corporate entity, the bustout entity, also setting up negative net worth statements showing a substantial decline in the corporate entity's worth from inception to the time of close. Also to try and trace merchandise from the corporate bustout entity to the outlets, and following those transactions through the outlets to its ultimate disposition.

In doing that, and going through these outlets, the way they conducted these transactions through their records, the unusual nature in which they did it, we used in helping to show the intent that these individuals, in fact, knew that the merchandise that they were acquiring was bustout.

The problem we have with bustout is, the bustout we can show in fact they ordered \$50,000 worth of merchandise, they received it, the bank records reflect, one, they never paid for anything. It is an excellent intent item. I can present that.

Going to the outlet, the outlet acquired the merchandise, and they sold it. Now it is very difficult to show their intent, that they were acquiring from somebody. They may be an unknowing buyer, but in auditing their records, one, we were able to show that their absence of purchase invoices for these items—

Senator DECONCINI. You are talking about the outlet.

Mr. AVILA. Yes. They would have, number one, they would either have no invoices acquiring this merchandise, or if they did have invoices, they would have absolutely no detail on the invoice identifying what they acquired. For example, they would have one job lot, \$18,000, with merchandise, not identifying the product—

Senator DECONCINI. What do they tell you when you ask the question, "Do you have any records or invoices to back this up?" What is their answer?

Mr. AVILA. I receive these records through grand jury, so I never had the opportunity to sit down with principals in corporate entity, but in going through corporate records we found that when there was no detail as to the purchase invoices, it was necessary for us to go to their sales invoices. In their sales invoices, in some cases we were able to see that they were selling the merchandise which was identical to the merchandise that the bustout store had busted out, was being sold at less than wholesale. So we were able to back into a position where they acquired the merchandise, or there is a presumption that they acquired the merchandise at less than wholesale.

Also, the payments to the companies—here we have the outlet company which is acquiring this merchandise, and, of course they want to be able to deduct it on their tax return. They have got sales that they have to report, and they want to be able to reflect the appropriate cost next to it. They have these checks that they have written to these particular bustout entities.

Now the bustout entity is in a particular situation where they can't deposit the money into the corporate checking account, because it is a traceable item. Nor does this outlet want this check particularly deposited into corporate account, because when we come in after the fact and secure the bank records of the bustout entity from the bank, we would be able to trace that item through deposited items.

One particular incident we had, the checks were issued to the— from the outlet to the bankruptcy, and the checks were issued to that company and endorsed in back by that company. One of the principals of the outlet would take that check to a particular bank where they had an arrangement, cash that check for cash, and never had to endorse it.

So from an audit standpoint, looking at the particular check, I would see the check issued to the bankrupt entity, and I would turn the check over, on the back would have the endorsement of the bankrupt entity, I would have a bank stamp. From all outward appearances from civil audit point, that check appeared to be normal business transaction, when in fact the principal of the outlet cashed that for cash, and we were talking about substantial amounts of money. The checks we were able to find were in excess of \$70,000.

Senator DECONCINI. Excess of 70?

Mr. AVILA. \$70,000, one particular entity. This is what we were able to find. They were all cashed for cash. Their money never gets into the bankrupt entity's corporate checking account.

Senator DECONCINI. Do you suspect that there are actual cash transactions for some of this?

Mr. AVILA. Absolutely. We have had circumstances where the outlet was paying in cash, never reporting the sale, never reporting the purchase.

Senator DECONCINI. There are obvious violations of the Internal Revenue Code?

Mr. AVILA. Absolutely.

Senator DECONCINI. Mr. Jigger, what about arson involved in some of these bustouts after the fact? Do you have any evidence that led you to believe that there is an organized effort in arson?

Mr. JIGGER. Yes, Mr. Chairman. It should be noted that our involvement in most of these cases comes after the fact, that the businesses have either been abandoned or placed into bankruptcy. Prior to that, from the initial commencement of these scams, there is planning which will be used to justify the demise of the business or to justify the absence of records.

Arson is one of those, where merchandise will be accounted for by the statement that it was all in the warehouse, and the warehouse burned down, or that the records were destroyed in a fire. But arson is only one of the justifications that is utilized. There are a number of others as well, including false thefts.

For example, a bustout operator will stage a robbery or report a robbery to the police, and he will use that police report when he is called into the bankruptcy court or when creditors inquire what happened to the merchandise.

Senator DECONCINI. A burglary.

Mr. JIGGER. Yes. He will say, I don't have the merchandise; it was stolen. In addition, a bankruptcy operator will hire people to work

for him with criminal records, and then claim that, well, much of the merchandise must have been stolen. They were robbing me blind. In addition, they will have phony accounts receivable from other bankruptcy fraud operators. They will account for missing merchandise by saying, I sold it to an ABC Discount. They owe me \$40,000. Coincidentally, ABC Discount is also bankrupted. Or they will use health problems, either mental health, physical health, heart attacks, or alcoholism to support the statement that, well, they had long periods of absence from the business, and don't know what their employees were doing. Finally, gambling habits can be used as a justification as to where the merchandise went, because for all of these things there is no crime against stupidity, and the businessman will say, call me what you will. I ran a poor business, I am a poor businessman, I can't account for the merchandise, this is my explanation.

Now the concealment is a central factor in the scheme, and the methods of concealment are only limited by the ingenuity of the operator. Some operators who, if they are taking the company into bankruptcy themselves, will leave a substantial amount of merchandise or will make partial payments to a number of companies, or pay some companies in full, all with the purpose of removing evidence of the intent to defeat the Bankruptcy Act. What we are speaking of here is a crime that is a crime in the head of the operator. Absent inside information from a witness who can testify, the only evidence can be of a circumstantial nature. These people are intelligent and they do their best to create circumstances which could rebut many of the inferences that would flow from such evidence.

Mr. O'SULLIVAN. I want to address the arson question one step further. We had one prosecution in the district of Rhode Island, recently leading to conviction in which principal defendants were sentenced to 5 years the other day, in which the captain in charge of the arson squad in the local police department testified that he was directed by the chief of police not to investigate a very substantial quarter million dollar fire. When he started to make some headway in proving the arson, he was removed from the investigation. That became public during the course of the trial. The chief was removed from his job by the municipality, but that is the kind of thing—the interaction we find at the law enforcement level.

Senator DECONCINI. Let me pursue that just a moment, Mr. O'Sullivan. Would you classify that as an exceptional case where you came across the police chief or the involvement of public corruption, or is that suspected by you in your investigations in other cases?

Mr. O'SULLIVAN. I would not classify that as an exceptional case. We find a number of cases, for instance, of defendants we have prosecuted with respect to these kinds of cases, letters from chiefs of police, heads of vice squads, attesting to what fine fellows these particular individuals are, even though they have prior convictions of loan shark, identified in public record as organized crime figures.

Senator DECONCINI. It is safe to say that the influence of the organized crime activity has spread wide in the area if, in fact, it has infiltrated some law enforcement.

Mr. O'SULLIVAN. Some law enforcement. I would say minority, but enough to be substantial problems when you are trying to do this.

Especially if you are running a bustout store, some of the local police officers see nothing wrong coming in and getting a piece of the action in terms of some of the merchandise in order not to disrupt the activities.

Senator DeCONCINI. When you come across this type of evidence, do you pursue that as part of this crime and part of your ongoing investigation?

Mr. O'SULLIVAN. Absolutely.

Senator DeCONCINI. Do you turn it over to another Justice agency?

Mr. O'SULLIVAN. Absolutely. We are pursuing that right now. Official corruption is departmental priority, and we are putting—again I think that the Attorney General, former Attorney General and present Attorney General in redirecting the priorities, have redirected us into this particular area. We are giving it a lot more consideration and investigative effort than even 2 or 3 years ago.

Most of our resources through the midseventies, and up until 2½ years ago were directed at illegal gambling. I believe illegal gambling is the source of a substantial amount of income for organized crime and I continue to believe that, but I think that the Department has decided we have to allocate our resources in a much more refined direction, and much more systematic types of problems. I think that we are now getting into areas that we just weren't into in any substantial way before.

Senator DeCONCINI. First of all, can you give me a general estimate, how many cases that you are involved in now also have some highly suspected corruption involvement from law enforcement or other public officials?

Mr. O'SULLIVAN. I suspect it in most cases, because I don't think illegal enterprises, loan-sharking enterprises could operate without knowledge of law enforcement, but I can't give you a percentage. We are just getting into this kind of area right now. Again, I would say knowing the kind of leads—we run a number of investigations in undercover projects with local law enforcers.

We were very successful the last couple of years. We ran an operation called Lobster in which we purchased approximately 25 truckloads of hijacked merchandise, truckloads of up to a quarter million dollars, undercover State police, undercover FBI agents, videotape garage, and used LEAA funds to pay for local law enforcement. I don't mean to condemn local law enforcement; I say it is a substantial problem.

Senator DeCONCINI. How high does it generally go, or is it case-by-case basis?

Mr. O'SULLIVAN. Case by case, but in major cities I think less so. When you get into smaller towns of 175 or 200 police officers, it can go all the way to the top.

Senator DeCONCINI. What about Federal law enforcement? Have you suspected or come across any improprieties or activities by Federal law enforcement?

Mr. O'SULLIVAN. No, we have not: not by Federal law enforcement. We have some qualms in that I think reform of the Bankruptcy Act is going to remove what appears to be collusion bankruptcy courts with appointment of trustees who are going to then handle—that is a

suspicion. There have been a number of newspaper articles. We have no evidence which would lead to indictment at the present time in that area.

Senator DeCONCINI. Do you have active investigations along that line as far as bankruptcy trustees or bankruptcy judges?

Mr. O'SULLIVAN. We have cases in which results of prosecutions and testimony before the court in current cases, the judge has written letters to bar associations, directing removal proceedings be commenced against certain lawyers involved in bankruptcy frauds.

Senator DeCONCINI. What about judges?

Mr. O'SULLIVAN. We have found no evidence at that particular level. This is an impression, we are only into this area for a couple of years, but my impression is that bringing—ventilating the system by appointing the trustees as a permanent branch of the court as is now under the new act is going to remove what has been a very closely controlled ball game between very few practitioners—the bankruptcy area is not such a specialized area that requires great legal skills. Anybody, I think, can practice bankruptcy law with a modicum of legal ability. It appears that there are only a few people who are getting the majority of the appointments, and what we were seeing one day is somebody representing creditors one day, and as a receiver, and the next day representing the bankrupt in another proceeding, and it was too limited, and it was just too made for collusion, I think is our impression of the situation.

I think the reforms are going to go a long way toward removing that particular temptation.

Senator DeCONCINI. Mr. Jigger, one last question regarding the arson and staged burglaries. You then, of course, come across fraudulent insurance claims, I presume, and do your investigative efforts go into that, and have you found that to be the case, and actual collections from insurance companies?

Mr. JIGGER. Yes, Mr. Chairman. In some instances there have been fraudulent insurance claims. There was one instance where we believed that the return from the insurance company was approximately \$460,000. There are other situations where no insurance claim is filed, that the only purpose behind the phony robbery is to substantiate the loss of the merchandise and for some reason an operator may not wish to expose himself to an insurance fraud.

Senator DeCONCINI. Do you think that has anything to do with the insurance company getting involved in investigation?

Mr. JIGGER. I think that is definitely a part of it.

Senator DeCONCINI. Do you find the insurance companies getting involved in these cases?

Mr. JIGGER. That could only be considered on a case-to-case basis. Some insurance companies would be very aggressive in looking into the fraud. Some insurance companies would merely pay—

Senator DeCONCINI. Can you give us any estimate, roughly, what you think the insurance claims have been during the last 2 years of your investigation? Do they mount into the millions of dollars?

Mr. JIGGER. I would say it would be somewhere between half a million and \$1 million. I do not have any definite details. I know that there was one that was close to half a million. I know there have been a number of other claims filed with insurance companies.

I am not sure of the exact figures on some of those, and some of them were not paid by insurance companies. They merely refused to pay off on the claims.

Senator DeCONCINI. Is there any prohibition of you giving us the names of some of those insurance companies at a later time?

Mr. O'SULLIVAN. No; there is not.

Senator DeCONCINI. We might want to make contact with them.

Mr. O'SULLIVAN. In any cases we have completed, our files are available for inspection by the staff. We will be glad to provide that. The only reluctance we have at this point is the fact that we do have current—we are in the final stages of a series of prosecutions which will, hopefully, be cleared off the books by the end of the year.

Senator DeCONCINI. Mr. O'Sullivan, time is catching up to us, and I greatly appreciate the detailed explanation. Let me just ask a couple of additional questions.

First of all, regarding the effort of this strike force investigation. do you find enough financial funding for the capacity of your office or do you need additional resources?

Mr. O'SULLIVAN. As a prosecutor, I could always say I need additional resources, but I think to be honest, and given the fact of life in government, the conviction of government in many respects, the attempt to cut down, we have no—if I can staff up to my authorized staff, and I have lost a number of attorneys recently—one was appointed as a judge, et cetera—if I can get back to authorized strength, we can conduct a good prosecutive program.

The problem as I see it, sir, is in the investigative agencies. I think that the impact of the retirement law on FBI agents, the loss of a lot of skilled agents, and, therefore, the necessity to bring young agents and rip them out of offices and bring them to Washington to staff positions when they show some leadership ability has been devastating, especially in light of contraction in a number of FBI agents.

Second, I have always believed that IRS was the best investigative force when it came to financial investigations. I used to be the Chief of the Public Corruption Unit in U.S. attorney's office. Many of your public corruption cases were generated through IRS audits.

I find that the Tax Reform Act and interpretations that have been put on Tax Reform Act by IRS have devastated us in our efforts in an attempt to conduct financial investigations.

I am aware enough to believe that that act is not going to change and we are going to have to live with it, but I think for the record it has been the worst thing that ever happened to law enforcement.

Senator DeCONCINI. Mr. O'Sullivan, can either you or your staff give us any specifics of the problems with Internal Revenue Code? That was one of the questions I wanted to ask you. Time is running short. Could you either verbally later or in writing set forth a few examples?

Mr. O'SULLIVAN. I will be glad to. I will be in contact with Mr. Feidler, and try to provide him with written statement or come down and talk to him about it. As a matter of fact, I have some sections of the IRS Manual that have just been implemented as of this October. I want to talk to people in the Department today to tell them a few more horror stories.

Senator DeCONCINI. It will be extremely helpful if you can share a few of those stories with us where tax reform has tied your hands.

Mr. O'SULLIVAN. One example: As you know, most strike forces have strike force representatives; each agency sends a representative to the strike force meetings. The purpose is to exchange information, to determine the state of organized crime in the particular area, to generate investigations be targeted to particular industries or problems.

The Internal Revenue Service representative of the strike force is a passive—he cannot contribute any information at all. Basically, the people would say that that is the intent of the Tax Reform Act.

IRS has taken it to such a degree that they interpret that to mean if my strike force representative, IRS criminal investigation agent, is out talking to a police department about corruption in a particular investigation, and this particular police officer tells him something about an organized crime figure, this organized crime figure just moved into our community, the IRS interprets the provisions of the Tax Reform Act to prevent—let's say at the next strike force meeting there is a question about where this individual is, and what he is operating on. He is not the subject of IRS case; IRS agent got this information when he was out talking to police chief talking about something independent. The IRS agent as interpreted by disclosure section of the Internal Revenue Service cannot contribute the fact that this individual is now operating in that particular town and he learned that from police officer. They consider that to be tax information and prohibited disclosure.

In effect, the IRS agent on the strike force has no active role at all, in effect, when you have one man sitting there and all other agents are contributing. They wonder what the other guy is doing there, and why he should be there in the first place. I think it has been devastating.

Senator DeCONCINI. Thank you very much. I appreciate the testimony you have given this morning, and we will ask you for some of these details on followup. We wish you every success.

One last question. Do you in the course of this effort work with assigned agents of State or local enforcement?

Mr. O'SULLIVAN. Yes, we do. The State police commissioner in Massachusetts is a former strike force representative from the FBI. He has been appointed commissioner about 1 year ago. He just appointed a State police officer as a strike force representative. We have had a number of undercover projects with local police department.

That gets us into Privacy Act questions immediately, and what kind of information we can give to local police department given criminal provisions. We are trying to work, given Privacy Act and those problems, we are trying to work through cooperative effort with the locals.

In the State of Rhode Island, we have a joint task force, made up of FBI agents and State police officers, working under the aegis of the strike force attorney that works for me working on organized crime problems down there. We are working very closely, given resource problems we do have with the locals.

Senator DeCONCINI. Would you classify those cooperative efforts as successful?

Mr. O'SULLIVAN. Yes: as I indicated. "Operation Lobster" was one of the most successful sting operations ever.

We aren't going for street criminals; we were going for truck hijackings. The number of hijackings since prosecuted—there has only been one hijacking in the Massachusetts-New Hampshire—from Rhode Island up to Canada, there has only been one truck hijacking. That was an independent operation.

In effect, a truck hijacking is no longer a business in this area of the country.

Senator DeCONCINI. I think the people of that area owe you and local law enforcement officials thanks, and I thank you in their behalf for that effort. When you can curtail or reduce any of the organized crime activity, we are moving in the right direction.

I want to point out that, indeed, Attorney General Bell and Attorney General Civiletti, both testifying at their confirmation hearings before the Judiciary Committee, were very positive they were going to move in the direction that you have indicated that you have been involved in the last 2 years, and it is very demonstrative of their commitment to their office, and the commitment of the administration to attempt to rectify some of the problems with organized crime.

Gentlemen, thank you very much.

Mr. O'SULLIVAN. Thank you.

Our next witness is Mr. Walter Downing. Mr. Downing has been made available to us by the Department of Justice. Mr. Downing has participated in five bankruptcy scams. He was charged for these activities. He has cooperated with the Government and has been sentenced to 1 year of incarceration after a plea to RICO conspiracy.

We are advised that Mr. Downing's testimony has been extremely helpful to the Government in their ability to secure other convictions. We would like to pose some questions to you, Mr. Downing. We appreciate your being here today with the intent of helping us understand the particular problems.

I wonder if you can go into a little bit of the background involvement of the scope of the involvement that you had personally with some of the bankruptcy cases and tell us how many there were, what dollar amounts, and what involvement organized crime had in those bankruptcy cases.

#### STATEMENT OF WALTER DOWNING

Mr. Downing. Sir, I backed into the bustout business in the fall of 1975. I was medically disabled at this time, and my involvement in the first three was driver-salesman and buyer, and these three had very definite organized crime connections.

Senator DeCONCINI. How did you get involved in those companies?

Mr. Downing. I have a brother that was very actively involved.

Senator DeCONCINI. He was in it and solicited you?

Mr. Downing. Yes.

Senator DeCONCINI. To become a driver-salesman?

Mr. Downing. That is right.

Senator DeCONCINI. All right.

Mr. Downing. In the summer of 1976, I incorporated a business known as North Quincy Corp. The purposes of incorporation were for the general wholesaling of merchandise. Based on some prior

experience, it was felt that the toy industry was ripe. As Ronald McDonald would say, they would do for a break today. We were going to concentrate on the toy industry, not limiting it just to toys.

I incorporated North Quincy Corp. I was fronting and it really didn't get underway until late fall of 1976 because there were still other ongoing bustouts that I was involved in, and couldn't devote myself to North Quincy full time. I didn't really start ordering until the fall of 1976, concentrating on some major toy companies, placing orders in the thousands, \$2,000 range, using bogus trade references. Because I had been in business before in a food concession, I had a very strong bank reference, which I manipulated to, in effect, be a very strong bank reference for the corporation. When you are dealing with a bank—

Senator DeCONCINI. How did you acquire that bank reference?

Mr. Downing. For many years I had successfully operated a food concession business and wholesale distributing of food products. When you incorporate and you have done business with the bank for years, even though you are now under the corporate umbrella, it is still the same individual, and it is difficult for a bank to distinguish—in terms of recommending for credit, credit worthiness, it is difficult for them to distinguish between corporation and the individual.

On that basis, I went ahead with North Quincy and I did place orders with toy companies and received the merchandise and paid for it; I established a modest track record through the holiday season in 1976.

In February-March 1977, I went down to the Toy Fair, the toy shows in New York. The toy industry is such that they do all their promoting and marketing in the winter or early spring of the year. Their industry is geared for the fourth quarter, and all preparations in marketing must be accomplished long before that.

Another advantage to toys is they offer tremendous dating, a term program, as much as a year; 6 months is common. They will ship now and payment isn't due for 6 more months. In June or July 1977, I got in several toy orders, the invoice value of some \$40,000. This was with nationally known corporations, nationally known toy manufacturers.

I put a lot together and I sold it locally for something like 30 percent of direct cost and funneled this money right back into the corporation for purposes of seed. That is, I would now use their money, which is not due for some time, to further finance my business and establish additional credit.

Senator DeCONCINI. If I understand you, you were able to establish a \$40,000 credit with one or more toy manufacturers?

Mr. Downing. That is correct.

Senator DeCONCINI. When you received the merchandise before you were billed for it, you would sell it at a substantial discount?

Mr. Downing. Thirty percent, yes, immediately.

Senator DeCONCINI. Obviously, you had no problem selling that.

Mr. Downing. Well, there was a lot of name quality toys.

Senator DeCONCINI. That money you would use to do what with?

Mr. Downing. I would deposit those moneys and use this to establish credit with companies that I was familiar with, other bankruptcies.

Senator DECONCINI. You used it in other bustouts you were working on?

Mr. DOWNING. Right. Companies I was familiar with that offered easy terms and had quality merchandise, merchandise that I could turn very quickly, again with the intent of paying some of these people as much as two, three times, and using them for trade references.

Senator DECONCINI. Would you never be completely current with any of these creditors?

Mr. DOWNING. Yes.

Senator DECONCINI. How long a period of time, to your recollection, would it take until they would extend you something like \$40,000 worth of—

Mr. DOWNING. I use that lot as an example. That figure was mushroomed from paying them in the \$1,000 and \$2,000 range. In other words, they shipped me and extended those terms based on my only having paid them a thousand or two.

Senator DECONCINI. For how long a period of time had you been paying them a thousand or two? For several months?

Mr. DOWNING. Once or twice.

Senator DECONCINI. There really was no difficulty in getting the credit?

Mr. DOWNING. No. Based on having paid them that little.

Senator DECONCINI. How many scams were you operating at that time?

Mr. DOWNING. Well, in the summer of 1976 when North Quincy was incorporated, I was actively involved in two others.

I was successful in getting on with a number of nationally prominent companies and getting them to ship quality merchandise to me. I would pay them two and three times, and in turn use this credit to establish more credit.

Senator DECONCINI. What areas were you primarily involved in, merchandise?

Mr. DOWNING. Categories of merchandise?

Senator DECONCINI. Besides toys.

Mr. DOWNING. Health and beauty aids, patent medicines, aspirin to vitamins, hair preparations, suntan lotion.

Senator DECONCINI. Did you have street outlets?

Mr. DOWNING. Yes. I had developed over 50 accounts in another bustout with independent druggists, chain drugstores, discount chains, auctioneers, flea market operators, jobbers, and the like. In September and October 1977, I proceeded on a mass purchasing via the mails and telephone. Here the object is, the more orders you get out—it is a numbers game—the more orders you get out, the more you will get in, contemplating busting out North Quincy after Christmas 1977.

Senator DECONCINI. You were involved in the toy bustout, and you were involved in a retail outlet to the public?

Mr. DOWNING. I was selling to the retail.

Senator DECONCINI. You were selling to retailers?

Mr. DOWNING. Yes. I operated no retail outlet myself.

Senator DECONCINI. They were all on the wholesale area.

Mr. DOWNING. That is correct.

Senator DECONCINI. When you would sell these items to the retailer, and you would offer them at a substantial discount, like 30 percent, did

you find a lot of inquiries by those retailers as to why there was such a good bargain, why they could buy this trade name toy brand from you at 30 percent less than they could 6 months ago or from another company?

Mr. DOWNING. No, sir. When price is right and you are agreeable to billing out this merchandise, giving them a proof of purchase, you encounter very little sales resistance.

Senator DECONCINI. They are very pleased to have it.

Mr. DOWNING. When the price is right.

Senator DECONCINI. And you would indeed give them a valid invoice that would protect them?

Mr. DOWNING. Yes, I would.

Senator DECONCINI. Do you have any reason to believe that any of them knew what you were up to at the time?

Mr. DOWNING. It is standard in the business that you don't ask too many questions. The invoice protects them. This is an insurance that it is not stolen or hijacked merchandise. You wouldn't give an invoice for stolen or hijacked merchandise. They know that it is something less than kosher, where you are able to offer this kind of discount.

Senator DECONCINI. As long as they have an invoice, they feel protected.

Mr. DOWNING. I think in most instances, yes; they knew this was bustout merchandise. In the Boston area, it was so common a practice—what else can it be if he is willing to write an invoice.

Senator DECONCINI. Just how big do you believe the problem or the area is in Boston that is involved in these bustouts? Would you call it a multimillion-dollar annual business?

Mr. DOWNING. Very definitely.

Senator DECONCINI. Very definitely. And yourself, Mr. Downing, in just the one instance of the toy outlet, what kind of volume did you process through that corporation in a year or a period of time?

Mr. DOWNING. I believe the figures, as finally put together by the assignee for the benefit of creditors, was approximately \$250,000.

Senator DECONCINI. Out of that \$250,000, was that the total amount that was due at the time that your company went into bankruptcy?

Mr. DOWNING. Into assignment, yes.

Senator DECONCINI. Was any of that collected or recaptured?

Mr. DOWNING. There was an auction, sir. I think they realized some \$20,000 from the auction, merchandise I had left behind.

Senator DECONCINI. The other involvement that you had, you said you had at least one more or two more at the time. Were these similar type schemes?

Mr. DOWNING. Yes; they were wholesale operations.

Senator DECONCINI. Did you, in fact, order the bulk of your merchandise, whatever scheme that you were involved in, from out of State? Or did it make any difference?

Mr. DOWNING. Practically speaking, no, it didn't make any difference. In the beginning you are concerned about quality merchandise: Electronics, small appliances, name brands; that they offer dating terms, credit terms, give you 90 days, 180 days to pay.

Senator DECONCINI. Would a company give you 90 days based on your bank credit that you could establish?

Mr. DOWNING. It would be the individual company's policy in terms that they offer.

Senator DeCONCINI. What was the largest you ever received, \$40,000 at one billing without any payment?

Mr. DOWNING. Myself?

Senator DeCONCINI. Yes.

Mr. DOWNING. Yes, but I know of much higher figures.

Senator DeCONCINI. You do know of higher?

Mr. DOWNING. Yes.

Senator DeCONCINI. When you can establish that type of credit, is it done without any personal interview? Through the mail?

Mr. DOWNING. Through the mail. Sometimes if the order is so large that it sort of breaks the pattern, the companies have assessed you—they will make an initial assessment as to what your buying potential is, and if you break that pattern, there will be telephone calls. Usually a financial statement will satisfy them. They are looking for a financial statement, some kind of oral explanation as to why you are upping your order so substantially.

Senator DeCONCINI. Were you involved in any activities of mysteriously disappearing merchandise after you had received it, other than selling it?

Mr. DOWNING. Yes. With the contemplated bankruptcy of North Quincy Corp., I staged a B. & E.

Senator DeCONCINI. B. & E.?

Mr. DOWNING. Breaking and entering of the premises, the warehouse.

Senator DeCONCINI. What amount of merchandise was involved in that B. & E.?

Mr. DOWNING. Some 20-odd thousand dollars I reported as stolen.

Senator DeCONCINI. You reported it to whom?

Mr. DOWNING. Local police.

Senator DeCONCINI. Did you make an insurance claim?

Mr. DOWNING. Yes, I did.

Senator DeCONCINI. Did you collect on the insurance?

Mr. DOWNING. At the time I staged the break, I didn't have any realistic chance or expectation of receiving an insurance settlement myself, but rather the intent was, it covers loss of merchandise for which I might be accountable, and it is something down the road that the lawyers can fight for if they are interested.

I didn't personally expect to get any insurance out of it, but I know the lawyers, if they wanted to pursue it, could do it.

Senator DeCONCINI. But in a way, the collection or claim of insurance company for the loss would, in fact, be able to provide funds to make the payments that you owed?

Mr. DOWNING. Yes. This is done. I had personal knowledge, that has been done.

Senator DeCONCINI. That has been done?

Mr. DOWNING. Yes.

Senator DeCONCINI. That is one way of paying those bills, or at least partial payment of them?

Mr. DOWNING. Absolutely.

Senator DeCONCINI. When you got involved in the breaking and entering, how did you go about finding the people to accomplish this? Was it through your brother or—

Mr. DOWNING. No, I had done it myself. I did it myself. You mean the actual staging?

Senator DeCONCINI. Yes.

Mr. DOWNING. I did it myself.

Senator DeCONCINI. When that was accomplished, what did you do with that merchandise?

Mr. DOWNING. I had sold it out the back door before staging the break.

Senator DeCONCINI. I see. You had already sold it.

Mr. DOWNING. Yes.

Senator DeCONCINI. When you sold it, did you sell it always for cash?

Mr. DOWNING. Yes.

Senator DeCONCINI. What kind of reduction from your cost would you average?

Mr. DOWNING. That would depend on the quality of the merchandise, anywhere from 15 percent off the direct cost to 35, 35 off direct cost.

Senator DeCONCINI. Who would you normally sell it to?

Mr. DOWNING. Independent jobbers, flea market operators.

Senator DeCONCINI. Independent jobbers and flea market operators, were they—

Mr. DOWNING. Small discount stores.

Senator DeCONCINI. Small discount stores. The independent jobbers, were they organized crime, to your knowledge?

Mr. DOWNING. No.

Senator DeCONCINI. What were they going to do with the merchandise; do you have any idea?

Mr. DOWNING. They had their own outlets.

Senator DeCONCINI. You did not know them from the standpoint of their organization?

Mr. DOWNING. No.

Senator DeCONCINI. You say they were independent jobbers. Did you have any reason to believe they might have been in the same kind of business you were in?

Mr. DOWNING. The independent jobbers knew that it was bankruptcy fraud.

Senator DeCONCINI. They knew what you were doing.

Mr. DOWNING. Definitely.

Senator DeCONCINI. What about small outlets; did they know what you were doing?

Mr. DOWNING. In most cases, yes.

Senator DeCONCINI. And, of course, you could supply no invoices?

Mr. DOWNING. Not in the final stage, no. It would have to be all cash.

Senator DeCONCINI. When you received the funds from those sales, where did you deposit, or what did you do with those moneys? Did you put those into the company at all?

Mr. DOWNING. No. This is in the fourth quarter, the final stage of the bankruptcy fraud, and I put it in my shoebox.

Senator DeCONCINI. When you made the amount of one of the B. & E., \$29,000, is that the value of the breaking and entering—

Mr. DOWNING. Yes.

Senator DeCONCINI. What percentage, what kind of return would you get, what would you sell that for, if it was \$29,000 cost to you, what would you get by selling it out the back door?

Mr. DOWNING. \$21,000, \$22,000.

Senator DeCONCINI. When you want to sell it out the back door, how do you find buyers? Do you know these people by reputation?

Mr. DOWNING. Yes.

Senator DeCONCINI. Is it very common knowledge among wholesalers or even retailers who these people are?

Mr. DOWNING. No, it wouldn't be common knowledge.

Senator DeCONCINI. How do you find that out? Where is the source of knowing, if I am in business, and all of a sudden I decide I want to sell something out the back door to an independent jobber, how do I find that person who will pay me cash and not require an invoice?

Mr. DOWNING. Look in the yellow pages.

Senator DeCONCINI. Under what? Independent jobbers?

Mr. DOWNING. Wholesalers of general merchandise.

Senator DeCONCINI. Wholesalers of general merchandise?

Mr. DOWNING. Yes.

Senator DeCONCINI. These people that you would deal with had the appearance of being legitimate themselves?

Mr. DOWNING. Yes.

Senator DeCONCINI. Do you have any idea from working with them what they would do with that merchandise?

Mr. DOWNING. They in turn would have outlets of their own, just as I had outlets, but I didn't have that many that could pay cash or were agreeable to paying cash.

Senator DeCONCINI. You had no problem in unloading that type of merchandise?

Mr. DOWNING. No.

Senator DeCONCINI. I take it, it is fair to say that, to the best of your knowledge, that is a very common process, at least in the Boston area.

Mr. DOWNING. It is fairly widespread.

Senator DeCONCINI. How long have you been involved in that type of activity?

Mr. DOWNING. As I say, I backed into it in the fall of 1975.

Senator DeCONCINI. 1975. So a couple of years.

Mr. DOWNING. Yes, sir.

Senator DeCONCINI. In the process of your involvement, Mr. Downing, did you come across any contact with local law enforcement or any law enforcement officials?

Mr. DOWNING. None whatsoever.

Senator DeCONCINI. When you would report the particular loss to the police, that would be the only contact you would have?

Mr. DOWNING. Yes.

Senator DeCONCINI. To your knowledge, did you know of any law enforcement officials not enforcing the law or taking it very lightly when complaints were filed along this line?

Mr. DOWNING. When you speak of law enforcement, you are speaking—

Senator DeCONCINI. Police.

Mr. DOWNING. Police, no.

Senator DeCONCINI. Were you ever investigated by local law enforcement as a result of the reports that you made?

Mr. DOWNING. No. There is a theory on the street that you 'don't have to be—you don't have to stage a very elaborate breaking and entering; you just merely report the loss and the police will explain how it happened.

Senator DeCONCINI. You were involved in a company named Van Gel?

Mr. DOWNING. Yes.

Senator DeCONCINI. Can you tell us a little bit about it?

Mr. DOWNING. Having successfully concluded the busting out of North Quincy Corp., I was interested in starting another bankruptcy fraud right away, but I now had used my own name, and I required a front man, and started Van Gel Marketing in the early winter of 1978.

Senator DeCONCINI. Who is the front man?

Mr. DOWNING. A hustler, a street hustler.

Senator DeCONCINI. And the Van Gel became the corporation?

Mr. DOWNING. That is correct. He was my straw.

Senator DeCONCINI. Your what?

Mr. DOWNING. My straw.

Senator DeCONCINI. It appeared in the record that he owned the company, and he was the incorporator, and he was really a front for you.

Mr. DOWNING. Correct.

Senator DeCONCINI. What involvement, to your knowledge, did organized crime have in that case?

Mr. DOWNING. Down the road, as we went along in the early stages of Van Gel, I became somewhat dissatisfied with my associate in terms of—he didn't follow directions, he didn't put the time in. I decided it was necessary, unless I was prepared to sink a lot of seed money into Van Gel out of my own pocket, that I was going to have to change the format of Van Gel Marketing, and I elected to do that. What I did was I had the business sold to a phantom, to a nonexistent person, after having placed ads in the Wall Street Journal and Boston Globe business opportunity section. We brought a fellow out of Chicago. He sat down with lawyers, purchased the business; my front man took a \$15,000 secured parties lien on the business, all of this giving it, the transfer, an air of legitimacy.

From that point on, the intent was a mass purchasing with no intent to pay anybody, leaving not so much as a cardboard behind for creditors, and now I needed an outlet that I knew could take large quantities of merchandise, any kinds of merchandise. However, the terms would be 50 cents on the invoice value of the merchandise.

Senator DeCONCINI. Excuse me; I don't quite understand. First of all, you had a strawman, and I understand that. Then you advertised to sell that company?

Mr. DOWNING. That is correct.

Senator DeCONCINI. Did you find a legitimate purchaser?

Mr. DOWNING. No.

Senator DeCONCINI. That was staged?

Mr. DOWNING. Yes. We brought a body out of Chicago representing himself as John Q. Campbell.

Senator DeCONCINI. How did you get that contact?

Mr. DOWNING. My associate arranged it. He had a friend in Chicago that corresponded as a result of this classified ad in the Wall Street Journal.

Senator DeCONCINI. How did you get to know the associate, your strawman, your front man?

Mr. DOWNING. As I say, he was a street hustler who had bought at North Quincy.

Senator DeCONCINI. He had bought from the other company?

Mr. DOWNING. Yes.

Senator DeCONCINI. Was he, to your knowledge, a member of organized crime?

Mr. DOWNING. He liked to give that impression. I don't know exactly if he was.

Senator DeCONCINI. When you put together this fictitious sale, you drew instruments transferring the corporate stock of Van Gel to Mr. Campbell; is that what you did?

Mr. DOWNING. That is correct.

Senator DeCONCINI. What was the advantage of that operation?

Mr. DOWNING. The mechanics of the transfer were such that they were accomplished in attorneys' offices. This was an added buffer to terms of tracing the actual ownership of the business to me.

Senator DeCONCINI. If somebody wanted to look at this, they would find, first, Van Gel was incorporated by your front person, and then it was sold to Mr. Campbell, and in actuality you were the main person behind it?

Mr. DOWNING. Yes.

Senator DeCONCINI. After that occurred, what did Van Gel involve itself in?

Mr. DOWNING. Having decided to go this route, I knew that I could not sell to local retail outlets, chains and the like, jobbers. I would require somebody, one individual or organization that could handle anything in any quantity, and I knew of just such an individual.

Senator DeCONCINI. Anything of any quantity?

Mr. DOWNING. Any category of merchandise in any quantity.

Senator DeCONCINI. They would buy it from you?

Mr. DOWNING. Yes. At a reduced—

Senator DeCONCINI. Were there people associated with criminal activities?

Mr. DOWNING. Very definitely.

Senator DeCONCINI. Were you, how did you happen to know those people?

Mr. DOWNING. They were involved in the three prior bustouts that I had some involvement—

Senator DeCONCINI. You had done business with them before?

Mr. DOWNING. Not directly, but I was involved in bustouts that they were doing business with. I knew them personally and by reputation.

Senator DeCONCINI. You then knew that you could get rid of anything that you could get legitimately or illegitimately purchased?

Mr. DOWNING. Right, and it wouldn't be traced to me.

Senator DeCONCINI. You commenced on that effort. What kind of business was Van Gel?

Mr. DOWNING. It was incorporated as a wholesaler of general merchandise, but I thought that if I represented it as a premium house, selling to religious and fraternal groups for fund raising, et cetera, it would give the legitimate air of legitimacy, which in fact it did. It was specialized.

Senator DeCONCINI. What would you sell to them? What type of merchandise did you try to secure under that kind of front?

Mr. DOWNING. Anything and everything.

Senator DeCONCINI. Furniture, or was it specialized order?

Mr. DOWNING. Soup to nuts, A to Z.

Senator DeCONCINI. How much merchandise did you order through Van Gel?

Mr. DOWNING. Van Gel was somewhat aborted by Federal authorities, but up to that point it had received in excess of \$200,000, \$230,000.

Senator DeCONCINI. That merchandise was distributed or you got rid of it through this organized crime outlet?

Mr. DOWNING. Yes. Fair portion of it.

Senator DeCONCINI. What period of time did that take?

Mr. DOWNING. That dollar amount represents just several weeks of purchasing.

Senator DeCONCINI. And then after that sale, did you cause Van Gel to file bankruptcy?

Mr. DOWNING. I don't understand—

Senator DeCONCINI. How did Van Gel become bankrupt? Did it go into the bankruptcy court?

Mr. DOWNING. After I commenced cooperating with the authorities. It was a long way from actual bankruptcy at termination.

Senator DeCONCINI. How did you decide to become cooperative with the authorities?

What slowed you down in this effort? It sounds like you had a booming business.

Mr. DOWNING. I was being increasingly hassled by certain individuals. The agreement was 50 cents on the dollar; that is, 50 percent of the invoice value of the merchandise that I was selling to them. They were holding ever-increasing amounts of money back on me. They represented it as leverage, so that—leverage for them so that I wouldn't sell to others. Their expressed concern was that I would sell them the crap, selling the quality merchandise to other outlets, and I became increasingly dissatisfied with this.

There were words and tempers, and I said some things that prompted—I was advised as a result of some things that I had said that I had signed my death warrant, and I then commenced to cooperate with them.

Senator DeCONCINI. Did this outlet have a name, a legitimate name?

Mr. DOWNING. Yes; it did.

Senator DeCONCINI. Can you give us that name?

Mr. DOWNING. I was advised not to mention any names.

Senator DeCONCINI. Is it still operating, to your knowledge?

Mr. DOWNING. Yes.

Senator DeCONCINI. I take it from your reference that indeed you were intimidated or threatened on several occasions by this outlet or their representatives?

Mr. DOWNING. That is correct.

Senator DeCONCINI. And this is what caused you to become desirous to cooperate with authorities?

Mr. DOWNING. That is correct, sir.

Senator DeCONCINI. And can you give us, Mr. Downing, any speculation that you might have regarding the magnitude of this type of operation, particularly Van Gel, dealing with the outlet that you make reference to? Do you know anything about that outlet, does it operate with a number of Van Gel types in the Boston area?

Mr. DOWNING. Yes, yes, it does, or it has.

Senator DeCONCINI. To your knowledge, is it still in operation?

Mr. DOWNING. Yes.

Senator DeCONCINI. Would you classify it as a multimillion dollar operation?

Mr. DOWNING. Yes; not on appearances, at the retail level, but they wholesale certainly in the multimillion dollar.

Senator DeCONCINI. Do you have any knowledge as to where they distribute or get rid of the merchandise that they purchase from people like Van Gel?

Mr. DOWNING. Throughout the megalopolis, Boston to Washington.

Senator DeCONCINI. Do they take it across State lines?

Mr. DOWNING. Yes; I don't know if they come as far south as Washington, but certainly down through Philadelphia and New Jersey.

Senator DeCONCINI. Do you have any information that you could tell us as to what kind of return they receive, have you ever talked to any of their representatives? If they buy it from you at 50 cents on the dollar, what do they get for it?

Mr. DOWNING. Probably again depending on the quality of the merchandise, they would be working on a 20- to 30-percent workup.

Senator DeCONCINI. Markup?

Mr. DOWNING. Markup.

If they are putting it into their own retail outlets, then it is 100 percent plus. I am sure they try to get more than direct cost at retail level.

Senator DeCONCINI. This particular outlet that you were dealing with through Van Gel, to your knowledge, did they have what appeared to be legitimate store outlets?

Mr. DOWNING. Yes; they did.

Senator DeCONCINI. In the Boston area?

Mr. DOWNING. Yes.

Senator DeCONCINI. And in other areas as well?

Mr. DOWNING. I think their wholesaling was primarily out of State.

Senator DeCONCINI. So in the Boston area, they were retail outlets and wholesale?

Mr. DOWNING. Yes.

Senator DeCONCINI. Mr. Downing, I want to thank you for your testimony this morning. I think it will be extremely helpful in the

deliberations of this committee to hopefully stem the tide in this area. And I realize that it is difficult for you to proceed in the way you have done, whatever your reasons for doing so. I think the information that you have given us will help us demonstrate how sophisticated this problem is.

One other question, in your involvement here, were you operating solely by yourself or did you have other partners, not counting this front man?

Mr. DOWNING. I had other partners.

Senator DeCONCINI. You had other partners as well?

Mr. DOWNING. Yes.

Senator DeCONCINI. Were they involved in most of your schemes, the same partners or did you have different partners in different operations? Were a significant number of these particular partners, to your knowledge, involved in other criminal activity also?

Mr. DOWNING. Yes.

Senator DeCONCINI. And prior to becoming involved in this activity, what businesses were you in?

Mr. DOWNING. For many years I operated a Pepperidge Farm franchise.

Senator DeCONCINI. In the Boston area?

Mr. DOWNING. In the Boston area. I had State and city concessions, food concessions.

Senator DeCONCINI. In those particular efforts, were there any bankruptcy involvements?

Mr. DOWNING. No.

Senator DeCONCINI. I have no further questions. Thank you very much.

The committee will go into closed session. We will take a 5-minute break, and then we will hear from the witnesses in that closed session. So if those in the room would please clear the room except staff of the committee and members of the committee.

The members of the strike force may remain.

[Whereupon, at 12:43 p.m., the subcommittee recessed, to reconvene in closed session.]

[The prepared statement of Nick Akerman follows:]

PREPARED STATEMENT OF NICK AKERMAN

My name is Nick Akerman. I am an Assistant U.S. Attorney from the Southern District of New York, where I have been employed for the past 3½ years. Prior to that I was an Assistant Special Watergate Prosecutor in the Watergate Special Prosecution Force.

Accompanying me is Brendan Fisk, a Special Agent of the Federal Bureau of Investigation, assigned to the Organized Crime Section of the New Rochelle, N.Y., office of the FBI.

I was responsible for the prosecution of the case of *United States v. DePalma et al.* which charged 10 defendants with forming and operating the Westchester Premier Theatre, a live entertainment complex in Tarrytown, N.Y., through a pattern of racketeering over approximately a 6-year period. This pattern of racketeering consisted of two parts, stock fraud and bankruptcy fraud. The defendants charged in the indictment included members of organized crime families of the La Cosa Nostra, Wall Street stockholders, and executives in the entertainment industry.

The trial of this case began in October 1978 and ended in a hung jury in January 1979. A second trial which began in March 1979 ended successfully with convictions in May 1979. In total, six of the defendants were convicted, two were

acquitted, one defendant who was severed is still awaiting trial, and another defendant had his conviction set aside by the judge because the Government did not grant his witnesses immunity. That issue is currently being appealed to the second circuit.

The evidence which unfolded at trial revealed a massive scheme to defraud innocent members of the public which began in 1971 when Eliot Weisman, and his two undisclosed partners, Gregory DePalma, and Richard Fusco conceived the plan to build a live entertainment facility in Westchester County to be called the Westchester Premier Theatre. In the spring of 1973 these three partners, who were the three core defendants in this case, sought to raise over \$2 million for the construction of the Theatre through a public offering of common stock.

Despite the fact that these defendants had deliberately concealed from the public that DePalma and Fusco were undisclosed principals in the Theatre because of their prior criminal records, they still found that they were unable to sell the full 275,000 shares to the investing public which the terms of the public offering required had to be sold by June 14, 1973. If the 275,000 shares were not sold, the defendants would have been required to refund the money to those purchasers who had bought the stock, and the Theatre would not have been built.

Instead of conceding to the public that the offering was a failure, these defendants perpetrated a fraudulent scheme to make it appear as though the full 275,000 shares of stock had been legitimately purchased by the public. To that end, they secretly raised upwards of approximately \$300,000 in cash, much of it borrowed at usurious interest rates, from various organized crime figures including \$100,000 from Carlo Gambino. This cash was used for the fraudulent purpose of purchasing stock in nominee names controlled by the defendants to make it appear as though the stock was being purchased by members of the investing public and for the fraudulent purpose of making secret cash payoffs to induce others to purchase the Theatre stock.

In addition, this fraud on the investing public included certain secret promises to select purchasers of stock to induce them to purchase the Theatre stock. These undisclosed deals included a promise of one extra share of stock for every share that was bought in the public offering; a promise of business from the Theatre for purchasing Theatre stock; and a promise guaranteeing the purchaser of Theatre stock against loss, if the market value of the stock decreased after the public offering.

With the money from the stock offering and funds from other sources, the Theatre was built and began public operations in March 1975. From the outset the defendants skimmed off large portions of the Theatre's proceeds for their own personal enrichment and for the purpose of repaying the secret loans which had been incurred during the public stock offering in 1973. This skimming was accomplished through the sale of concert tickets for extra Theatre seats in the form of extra permanent seats and temporary folding chairs, which were not accounted for on the Theatre's ticket manifests and the proceeds of which were not reported on the Theatre's books and records. Receipts from the sale of tickets were also simply looted from the box office, and this theft was covered up by creating false documentation to make it appear as though certain concert tickets were given out as complimentary tickets wherein fact they had been sold. Additionally, moneys were skimmed off the proceeds from the sale of souvenir items at the concerts.

As a result of this massive drain on the Theatre's profits, on December 23, 1976, the Theatre became a debtor-in-possession in chapter XI bankruptcy proceedings. While the Theatre was operating under the control of the bankruptcy court, the defendants continued to skim money out of the Theatre to the overwhelming detriment of the Theatre's legitimate creditors who were being offered only 10 to 15 cents on the dollar.

In sum, this case is a classic example of the harm that can be inflicted on our society when organized crime operates an ostensibly legitimate business. As a result of the defendants' crimes, the losses to the public ran into the millions of dollars. The evidence at trial showed that the defendants deceived the public into investing approximately \$2 million through a public stock offering in a Theatre that had been secretly hocked to hidden interests, including top level members of organized crime such as Carlo Gambino. After the public offering, the repayment of these hidden interests and promises coupled with the defendants' own greedy desire to line their pockets by skimming off the proceeds of the Theatre resulted in all of the stockholders losing their investments and the Theatre's creditors losing \$9 million.

## BANKRUPTCY FRAUD OVERSIGHT

THURSDAY, OCTOBER 18, 1979

U.S. SENATE,  
SUBCOMMITTEE ON IMPROVEMENTS  
IN JUDICIAL MACHINERY,  
COMMITTEE ON THE JUDICIARY,  
Washington, D.C.

The subcommittee met at 9:40 a.m., pursuant to recess, in room 1202, Dirksen Senate Office Building, Senator Dennis DeConcini (chairman of the subcommittee) presiding.

Present: Senator DeConcini.

Staff present: Romano Romani, staff director; Robert E. Feidler, counsel; Pamela Phillips, chief clerk; Kevin O'Malley, staff assistant, and William Christensen, investigator.

### OPENING STATEMENT OF SENATOR DeCONCINI

Senator DeConcini. Good morning. The Subcommittee on Judicial Improvements in Judicial Machinery will come to order.

Today we will convene the second day of hearings on the general subject of bankruptcy fraud. Yesterday, the subcommittee heard from the head of the New England Strike Force on Organized Crime of the Department of Justice, several members of that task force, and two people convicted of perpetrating bankruptcy fraud.

In addition, an Assistant U.S. Attorney General from the Southern District of New York testified as to the successful prosecution and background of the *Westchester Premier Theater* case. It is clear from their testimony that bankruptcy fraud is a serious problem in our country and that remedial legislative steps should be considered that will assure the bankruptcy process is only used for the humane purposes for which it was designed and not as a haven for crime to be covered up.

It was also clear from yesterday's testimony that bankruptcy fraud is not simply a crime of street hustlers, but that well-known organized crime figures are also heavily involved.

Today's witnesses will focus on the economic impact of bankruptcy fraud and the special difficulties involved in tracking fraud cases of any kind. We will hear from representatives of credit association, a certified public accountant, Deputy Director of the FBI, and two attorneys who were dragged into the bustout of a cheese company in northern Wisconsin by members of organized crime.

Our first witness this morning will be Paul Leevan, attorney, National Association of Credit Managers.

We appreciate your coming yesterday.

STATEMENT OF PAUL LEEVAN, ATTORNEY, REPRESENTING  
NATIONAL ASSOCIATION OF CREDIT MANAGERS

Mr. LEEVAN. Good morning, Mr. Chairman. I am Paul S. Leevan, a partner of the law firm of Klinger & Leevan in Los Angeles, Calif. I have practiced law in Los Angeles for 20 years and our firm conducts an extensive trial practice in the State and Federal courts. I have also served as a deputy district attorney of Los Angeles County and as a consultant to the Judiciary Committee of the California State Assembly.

Today I represent the National Association of Credit Management, which is an organization composed of more than 43,000 businesses engaged in the granting of credit in the areas of manufacturing, wholesaling, service industries, and financing.

As the members of the association extend credit on a commercial basis, they are vitally interested in the detection and prevention of commercial fraud.

Mr. Chairman, a portion of my statement will be deleted this morning from my testimony, except I would like to have the statement received in the record, as much of the material that I would like to say this morning has been covered yesterday in the course of the hearing before yourself. I would like to continue with a brief discussion concerning the purpose of business and the nature of bustouts.

As you know, Mr. Chairman, the purpose of all business is to earn a profit. This can be accomplished through the making of investments, the sale of products or the furnishing of services. As to each, something of value is given in exchange for a promise, a promise to pay money. In the case of fraud, however, it is a promise clearly without any substance. In today's modern commercial world, the granting of credit is the lifeblood of business.

In a free and competitive market, one who is too conservative in granting credit often loses sales, and usually the company that is prepared to assume certain manageable risks will be rewarded with success. As in so many other comparable endeavors, the assumption of a certain risk is a matter of judgment. Nevertheless, when the risk taker, albeit a careful and prudent one, runs up against a "fraud artist," he is certain to lose.

Recently, in southern California in particular, a form of commercial fraud, referred to in the parlance of law enforcement as a bustout, has been used by criminal elements with great success. Generally there are two types of bustout schemes. In one, a wholly new business is formed, inventories are built slowly through cash payments and later through short-term credit purchases. The business is conducted in all respects in an exemplary fashion. Nothing is done to create suspicion.

Once a credit rating of some size and significance is achieved, which could occur a year after the startup of the operations, large orders totally out of character with the company's previous history are placed, not just with one creditor but with all of the company's creditors. The size of each order is directly related to the size and worth of the creditor. A proportionately larger order will be given to a major supplier whereas a smaller order will be placed with a modest-sized supplier. The object is to take as much advantage of the company's credit limits as possible without creating suspicion. Given past per-

formance, most if not all of the suppliers will fill the orders. As you might expect, both the merchandise and the business operator often vanish immediately afterwards. In other instances, the operator will remain, but the merchandise will be gone, allegedly caused by a fire or burglary.

Mr. Chairman, the other variation of this scheme occurs when a long established, honest business is purchased with little or no notice of the change of management to its creditors. Afterwards, usually during a seasonal peak such as at Christmas, larger than normal orders are made with the same predictable results, leaving the defrauded merchant with nothing but the commiseration of his fellow competitors who in all likelihood were similarly injured.

Bustouts have been prevalent for quite some time but recently they became a money machine for a new type of organized crime—a new type of Mafia—in southern California. Instead of being Sicilian origin, this group shares a Mideastern heritage. Because so many of them emigrated from Israel, they are often referred to as the "Israel Mafia." I was not aware of the existence of this group until March 1978, when I was retained by Lee J. Fortner and K. Richard Kaufman of Credit Managers Association of Southern California.

Several retail stores, apparently part of a bustout operation, had just closed, causing creditors to lose well over \$1 million. Other retail outlets in southern California and Arizona were thought to be part of the same criminal operation. Hardest hit were companies in the automobile and home stereo field, photographic field and television and appliance field. They had asked the fraud prevention department of the local Credit Managers Association to take action. The information we initially obtained was that bustout operations along the same lines described had been conducted since about 1975 by a group referred to as the Israeli Mafia, and local law enforcement authorities were unsuccessful in stopping them.

We were told that members of this group had cooperated with each other by allowing their names to be used as credit references and by serving as a conduit through which merchandise from a bustout operation would be disposed. We were also advised that in order to prevent their arrest, members of this Mafia had physically assaulted and murdered witnesses. Our source told us that if anyone with the local association were to investigate this group, he would be a "walking time bomb."

I advised Lee Fortner and Richard Kaufman that I doubted we would be in danger since we would be acting only as a conduit for information. In such a setting, our investigation continued. Our first task was to learn as much as we could from the information already available about the Israeli Mafia, who the members were, how they operated and why they had not been apprehended.

We discovered that their principal criminal activities started in southern California in about 1975. In the beginning, they engaged in extortion activities against Jewish and Israeli merchants in Los Angeles and Calexico, Calif. These merchants were confronted with the simple choice of either paying money or having their establishments burned. When some of the merchants refused, their stores were destroyed by fire. Other merchants, seeing what had happened, began to pay. In other instances, Israelis living in the United States were

compelled to comply with extortion demands because of threats that harm would be done to their relatives still residing in Israel.

Later, we believe members of the Israeli Mafia filed bogus burglary and theft claims with insurance companies, and using the moneys from all of these sources, they may have engaged in the illicit narcotics trade. They also moved successfully into the bustout type of operations. It is estimated they have "ripped off" merchants in southern California and Arizona in excess of several million dollars in the past 4 years.

Our information is that its members may not exceed 50 in number, and that this group operates like a hydra-headed monster, engaging in different criminal activities without a control center. Although the Israeli Mafia has been known to local law enforcement agencies for some time, no arrests of any consequence have been made primarily because of the refusal of witnesses to come forward. Witnesses have been intimidated by threatening telephone calls, and in some instances, by being physically beaten.

It was patently obvious to Lee Fortner, Richard Kaufman, and myself that a civil suit would be of no value. An immediate cessation of the Israeli Mafia bustout schemes and prosecution of the perpetrators were our principal objectives. To this end, a select group of involved creditors was formed to assist in the gathering of information. Members of the Credit Managers Association in Los Angeles were asked to provide us with any information of a suspicious nature and were cautioned by us to act prudently in certain situations.

We further called in the FBI, and, for the first time to our knowledge brought together representatives of the Federal and State law enforcement agencies to deal with this problem. Additionally, we acted as an important link between the members of the local association and the FBI so that the investigation would be accelerated and unimpeded.

To get the full and active support of the Federal law enforcement agencies, we urged members of the respective trade groups to write to Griffin Bell, the U.S. Attorney General, and William Webster, the FBI Director, strongly requesting that action be taken against the "Israeli Mafia." Members of the trade groups responded with alacrity and inundated these two offices with letters demanding that the Federal Government put a stop to this "Mafia" activity.

I am pleased to say three individuals who apparently were part of this group were arrested and convicted in Arizona. I am informed that the FBI has assigned additional agents to this investigation. Also, by subsequently allowing word of the investigation to become public, we believed that members of the "Israeli Mafia" would cease their bustout operations, and we understand that this has occurred. This does not mean that the "Israeli Mafia" is out of business. For the moment they have suspended their bustout operations. However, although more than 1 year has elapsed since these bustout incidences, no further arrests, to our knowledge, have been made.

The bustout schemes I have just described are sometimes characterized as a form of bankruptcy fraud since they arise from and are associated with a company going out of business. The losses from such scams have been estimated to be more than several hundred million dollars per year.

The major problems, as we see it, are threefold: (1) Getting the law enforcement agencies initially to investigate a suspected bankruptcy fraud; (2) obtaining some feedback of the results of the investigation from the authorities; and (3) causing the law enforcement agencies to prosecute the perpetrators of the fraud.

Senator DECONCINI. Let me ask you about your second major problem, that is, getting feedback from the results of the investigation. You mean to the clients and to the business community so they can protect themselves, is that what you particularly mean?

Mr. LEEVAN. What I was referring to is that after the matter is turned over, for example, to the Federal Bureau of Investigation, learning thereafter as to what progress the Bureau has made, because a year or more may elapse between the time the claim is initially filed, and the time that an arrest is made. In the meantime, the business community is frustrated because they haven't seen any arrest. They don't know if the FBI has been able to pursue the matter successfully, and they don't know what they should do in the future should a similar situation arise. That is what I am referring to by way of feedback.

Senator DECONCINI. Do you think from your experience, your clients and the business community would be satisfied if they were contacted by the law enforcement investigative agency and just informed that the case was still being pursued?

Mr. LEEVAN. I think they would request more than that.

Senator DECONCINI. That is a problem usually from law enforcement's point of view. If they come and tell you we are working on A, B, and C, and we are tapping their wires with a court order, et cetera, sometimes that is dropped at trade meetings or social functions or what have you, and it jeopardizes a case. There is some reluctance from law enforcement to even tell the complainant too much because they are not that deeply involved in it.

Mr. LEEVAN. Mr. Chairman, I appreciate that, and I think the business community understands that. What they would like to know is if the particular case is being investigated well; they don't need to have a report from the law enforcement agency as to what is being done in detail.

If they could just be told, yes: the case is being investigated, it is going well, and we hope there will be arrests shortly; something along those lines I think would suffice.

Senator DECONCINI. Now you feel the frustration that once the complaint and information is turned over, you hear nothing?

Mr. LEEVAN. Hear nothing. When I was brought into the case in March 1978, and I first spoke with the FBI about it, and caused them, I believe, to undertake the investigation of the "Israeli Mafia," we have heard nothing further from the Bureau, and it is now 1½ years. So far as we know, there have been no further arrests, nor do we know if any arrests are contemplated.

Senator DECONCINI. You don't know if the investigation is ongoing?

Mr. LEEVAN. We have been told it is ongoing.

Senator DECONCINI. By the FBI?

Mr. LEEVAN. By the FBI.

Senator DECONCINI. That is all?

Mr. LEEVAN. That is all.

Senator DeCONCINI. Thank you. Please proceed.

Mr. LEEVAN. Further, Mr. Chairman, it has been the experience of most creditors that the local authorities are loath to become involved in a fraud case involving complicated business transactions. It is our impression that most local police and district attorney's offices are geared primarily to deal with violent, highly visible crimes and properly so. Local law enforcement agencies have limited resources and are not as prepared as private civil attorneys to put together a complicated case involving hundreds of documents. The difficulty of showing corroboration for the crime and proving the case beyond a reasonable doubt are restricting factors to any successful local prosecution. To underscore the problem, it has been said that most investigations of any significant fraud scheme take 6 months to 1 year to be completed. Because of the substantial evidentiary items needed to be established, many fraud cases are started through indictments issued by the grand jury.

Recently the Supreme Court of California ruled that a defendant indicted by a grand jury is entitled to a post indictment preliminary hearing. While in many cases preliminary hearings are of short duration, such hearings in fraud cases can be quite extensive. Hence the cost of prosecuting fraud cases in California has increased greatly, and I suspect it will now be more difficult to get the local authorities to act.

Because of the apparent limitations inherent in any local investigation and prosecution, most creditors feel that their best chance of convicting persons engaged in commercial or bankruptcy fraud schemes are through the Federal Government. Yet, when the Federal authorities had been called upon for assistance, and if arrests are not made immediately, it appears to most creditors that the investigations undertaken by the Government seem interminable. Moreover, with no feedback from the authorities as to the progress or lack of progress being made in the investigation, creditors feel frustrated as a consequence. What happens then as a practical matter is that the losses sustained are considered by the creditors as a necessary cost of doing business which is then passed on to the consumer in the form of higher prices.

Whether the problems noted can be remedied by new legislation, such as the granting of additional authority to the trustees in bankruptcy to investigate bankruptcy fraud in no-asset estates and the amending of the present bankruptcy fraud criminal statute, or whether the problem can be remedied by an increase in the manpower of the FBI and the Department of Justice are matters that I am certain this committee will consider. But in the final analysis, unless some further effort is made to arrest the increase in commercial or bankruptcy fraud, creditors, like other private citizens, may lose faith in the system and decide that the only practical and realistic course available is to increase their prices in order to pass the losses sustained from such fraud to the consumer.

Finally, I would like to thank the members of this committee in affording me the opportunity of sharing some of my thoughts and experiences in the area of commercial or bankruptcy fraud.

Senator DeCONCINI. Mr. Leevan, let me go to a couple questions if you don't mind. In your experience of representing businesses and

associations that deal greatly with credit, what would you say is the average time or is there any average time that a business decides is necessary for a proper credit track record to extend large amounts of credit? Do they do that by performance?

Mr. LEEVAN. By performance, and I would say the average time would be approximately 6 months, 6 months to 1 year.

Senator DeCONCINI. If a customer is currently billing on a 6-month basis, you would say that on the average a business at that point would then be inclined to grant a greater amount of credit?

Mr. LEEVAN. I would say that would be true, Mr. Chairman, particularly in a highly competitive area market, and I think that would depend upon the particular situation.

Senator DeCONCINI. And how expensive is it for business that you are involved in to do thorough credit ratings from out-of-State customers or long distances when you can't just drive across town and visit them and talk to the banker yourself?

Mr. LEEVAN. I can't speak to the expense involved, but every large company has a large credit department with sophisticated credit people. And they have sources that they could contact out of State to see whether the particular debtor or proposed debtor is a worthwhile risk.

Senator DeCONCINI. We heard testimony yesterday that many of these people would be able to go to organized crime organizations that not only were the outlet for the bustout merchandise, but also would provide them with bank references and phony financial statements.

Have you come across any of that, to your knowledge?

Mr. LEEVAN. It is our belief that in connection with the Israeli Mafia the members of this particular group have done exactly what you have just indicated. They provided some of the members with good credit references and bank references, and when that is done, then I think they have at least at the outset a foolproof means of obtaining credit.

Senator DeCONCINI. It is pretty hard if you go to a credit certification organization that appears to be good and in fact has some legitimate clients or customers and they give you a green light.

Mr. LEEVAN. That is true.

Senator DeCONCINI. Regarding Israeli Mafia, first I assume these are not principally Jewish people, but Mideast in geographical terms.

Mr. LEEVAN. That is correct, Mr. Chairman.

Senator DeCONCINI. And you mentioned that your sources have indicated that they are very heavyhanded and, indeed, involved in extreme violence, intimidation of physical injury and even murder. Is your source of such a nature that they have experienced that type of intimidation?

Mr. LEEVAN. No, I would say the source of information I had was an individual with a law enforcement agency, who had investigated various crimes allegedly committed by the Israeli Mafia, and I am relying largely upon the information provided by this one party.

Senator DeCONCINI. You mention Arizona and California. Are they more centrally located in the Los Angeles area?

Mr. LEEVAN. I believe so. They are located primarily in the Los Angeles area and also in Calexico, Calif., which is in southern California.

Senator DeCONCINI. The cases you mention that resulted in some indictments in Arizona. I am only familiar with a couple of the names such as Erlich and Perez and Seifert.

Are you familiar with any of those names?

Mr. LEEVAN. I am familiar with the names.

Senator DeCONCINI. To your knowledge, is this part of that organization or do you know?

Mr. LEEVAN. I can't say for certain. I think it is a matter that is under scrutiny.

Senator DeCONCINI. Do you have any information of present activities, even reporting by the media, by the Israeli Mafia.

Mr. LEEVAN. On October 16 the Valley News, which is a newspaper located in the San Fernando Valley of Los Angeles, discovered that apparently two people had been murdered by the Israeli Mafia. If I could quote from just a portion of that newspaper account, this is an article which begins as follows:

The Israeli Mafia, an organized crime network that has infiltrated Los Angeles area, is under investigation in connection with last week's dismemberment murder of a North Hollywood woman, the Valley News has learned. The remains of Esther Rubin, 22, as well as part of a man's body, which may be that of her missing husband, were found packed in plastic bags in four large trash bins in Sherman Oaks and Van Nuys.

Senator DeCONCINI. Have you had any contact with the Valley News or any people out there?

Mr. LEEVAN. I have not.

Senator DeCONCINI. Do you know—can we see the balance of that article? Does it make any reference to continued investigation by that newspaper?

Mr. LEEVAN. I believe the newspaper is continuing the investigation, yes.

Senator DeCONCINI. Thank you. You raise my curiosity as to involvement of the Justice Department indicating that when you brought forth through your members substantial mail and demands, I think were the words that you used to the Attorney General and FBI, you did at least initially see some response. You also leave me with the impression that you are not sure that response is continuing, is that a fair estimate?

Mr. LEEVAN. I would say that would be true. Mr. Chairman. I believe that initially the FBI, at least in Los Angeles, had not heard of the involvement of the Los Angeles Mafia—or the Israeli Mafia. Afterwards, after I contacted them, they showed some interest.

I gained the impression that it was important to have additional agents assigned to this credit and follow it up because we were concerned, the credit community in Los Angeles was concerned, about the possibility of other bustouts occurring. We were aware of two in the southern California area. We had information that many others had occurred over the past 4 years, and that is why I had requested the members of the credit managers association and their group to write to the FBI Director and the Attorney General. And I thought as a response to those requests, the FBI assigned additional people to the case.

Thereafter, obviously this is the Bureau's practice, they were silent as to whether they were continuing with the investigation or not. We

got the impression that this was one of many cases that they were handling, and that they weren't giving this particular matter as much attention as it warranted. This may be, for they may have had difficulties of their own, based upon the current state of the law.

Senator DeCONCINI. Did you ever get any impression or any information that you felt like they didn't have enough resources or enough people?

Mr. LEEVAN. No one complained, but there was a distinct impression I received that the Bureau is lacking in additional manpower and resources in order to combat this type of crime.

Senator DeCONCINI. You mentioned local law enforcement being unable to do it because of their interest, and rightfully so, in more volatile, high-profile criminal activity. Do you have any feeling of the capability of local law enforcement to work in the area? Do you feel that they could be tainted in any way?

Mr. LEEVAN. I don't believe the local law enforcement agencies are tainted in any way. It has been my understanding that the Los Angeles Police Department apparently has known about the "Israeli Mafia" for some years, and I could recount a particular incidence that I was informed of where beatings and perhaps murders may have occurred in the Los Angeles area, and it is my belief that the Los Angeles Police Department knew about it.

My feeling is that they would like to be able to prosecute if they could secure sufficient information for a prosecution. I think they have all the competency and capability to pursue it if they were able to get the information and witnesses to support an indictment.

Senator DeCONCINI. That information source, of course, has to be the victims.

Mr. LEEVAN. The victims, obviously, and other information and other evidence that they might be able to gather.

Senator DeCONCINI. Or undercover activities in behalf of the law enforcement agencies. Let me ask you this; can you express an opinion as to the willingness of business to be involved in such problems?

Is there any truth to the fact that a lot of businessmen sure don't like to get ripped off and stuck with a lot of debts, but, boy, they are not looking to mess with the "Israeli Mafia" or any other "Mafia," and they would just more often just prefer to pay the bill and be left alone?

Mr. LEEVAN. Mr. Chairman, I believe there is a great deal of truth in what you say. I would say that over the past 10, 20 years that probably was the attitude of business, because what they would do then is take the cost or the losses and just pass it on to the consumer in the form really of indirect tax upon the consumer. The consumer winds up paying for the loss.

But I would say in recent years the business community has changed its philosophy concerning this type of matter, and are prepared to assume responsibility of dealing with the authorities. In fact, they are urging the authorities to move in the direction of prosecutions, and I think they would be very, very happy to cooperate in every way possible.

Senator DeCONCINI. In your opinion, if law enforcement was very aggressive in the area, Federal and local for that matter, would that bring forward more responsiveness from the business community?

Mr. LEEVAN. Unquestionably.

Senator DeCONCINI. One last question regarding the bankruptcy laws; with your experience do you have an opinion as to the problem we face today that these laws indeed appear to be a haven for this type of criminal activity? Is that your observation?

Mr. LEEVAN. That is my observation.

Senator DeCONCINI. They are able to cover their illegal activities through a very complicated system?

Mr. LEEVAN. That is correct. And I would say that, by and large, the creditors who have a bankruptcy filed, after discovering that there are little or no assets available to them, they will lose interest in pursuing the matter—recognizing that the creditors are business people, and they are primarily interested in seeing a return on their investment. They are not going to pursue a case, civilly or criminally, if they don't see any reason for doing so.

I would say, Mr. Chairman, the Bankruptcy Code perhaps could be strengthened by requiring the U.S. Trustee to conduct a fraud investigation whenever an interested party such as a creditor group should request such an investigation be undertaken, even in cases where there are few or no assets in the estate.

Obviously the burden and the cost of this would be borne by the U.S. taxpayer; but in the long run the taxpayers would be well served by such an investigation, because I think then the U.S. Trustee would pursue the matter and be able to uncover enough evidence of fraud through the means of depositions so that that evidence can be turned over to the Bureau and the Department of Justice. That would be a very important factor in stopping fraud. And I would urge, Mr. Chairman, that you consider such a change in the law.

Senator DeCONCINI. Very helpful suggestion. Indeed, we will consider it. Thank you very much. We appreciate your testimony. I wish you would please extend our thanks to the National Association of Credit Managers for their cooperation.

Mr. LEEVAN. Thank you.

[The prepared statement of Mr. Leevan follows:]

PREPARED STATEMENT OF PAUL S. LEEVAN

I am Paul S. Leevan, a partner of the law firm of Klinger & Leevan in Los Angeles, Calif. I have practiced law in Los Angeles for 20 years, and our firm conducts an extensive trial practice in the state and federal courts. I have also served as a Deputy District Attorney of Los Angeles County and as a consultant to the Judiciary Committee of the California State Assembly. Today I represent the National Association of Credit Management, which is an organization composed of more than 43,000 businesses engaged in the granting of credit in the areas of manufacturing, wholesaling, service industries and financing. As the members of the Association extend credit on a commercial basis, they are vitally interested in the detection and prevention of commercial fraud.

At the outset, it must be emphasized that a failure to pay a debt or perform a contract does not in and of itself constitute fraud. For our purposes, fraud can be said to have occurred in those cases where the perpetrator intentionally makes a misrepresentation of a fact or promises to perform an obligation in the future while all of the time knowing that he has no intention of performing it.

As we all know, the commission of a fraud often gives rise to both civil and criminal actions. In such an event, the victim's immediate desire is to recover the lost property or money. If it cannot be recovered voluntarily or through the efforts of law enforcement authorities, a civil action will be considered. But for any such action to have a realistic chance of being successful and not just represent a pyrrhic victory, it is essential that the defendant be financially

responsible with sufficient roots in the community so that a judgment several years hence will be recoverable. For this reason most civil actions for fraud are brought against a company or professional whose conduct in the main has been lawful but whose actions in a specific situation are questionable and appear to have been motivated out of a desire to accomplish a certain designated objective without serious regard for the truth or the accuracy of the representations.

But criminal fraud, in my opinion, is of a different kind and nature. To the persons who commit this type of crime, fraud is their main pursuit and a lawful business operation is merely a "cover" to hide their true intentions. It is to this type of fraud that I wish to principally address my remarks in the course of my testimony.

As we all know, the purpose of business is to earn a profit. This can be accomplished through the making of investments, the sale of products or the furnishing of services. As to each, something of value is given in exchange for a promise—a promise to pay money. In the case of fraud however, it is a promise clearly without any substance. In today's modern commercial world, the granting of credit is the lifeblood of business. In a free and competitive market, one who is too conservative in granting credit often loses sales, and usually the company that is prepared to assume certain manageable risks will be rewarded with success. As in so many other comparable endeavors, the assumption of a certain risk is a matter of judgment. Nevertheless, when the risk taker, albeit a careful and prudent one, runs up against a "fraud artist", he is certain to lose. Recently, in Southern California in particular, a form of commercial fraud, referred to in the parlance of law enforcement as a "bustout", has been used by criminal elements with great success.

Generally there are two types of "bustout" schemes. In one, a wholly new business is formed, inventories are built slowly through cash payments and later through short term credit purchases. The business is conducted in all respects in an exemplary fashion. Nothing is done to create suspicion. Once a credit rating of some size and significance is achieved—which could occur a year after the start up of the operations—large orders, totally out-of-character with the company's previous history, are placed, not just with one creditor, but with all of the company's creditors. The size of each order is directly related to the size and worth of the creditor. A proportionately larger order will be given to a major supplier whereas a smaller order will be placed with a modest sized supplier. The object is to take as much advantage of the company's credit limits as possible without creating suspicion. Given the past performance, most if not all, of the suppliers will fill the orders. As you might expect, both the merchandise and the business operator often vanish immediately afterwards. In other instances, the operator will remain, but the merchandise will be gone, allegedly caused by a fire or burglary.

The other variation of this scheme occurs when a long established, honest business is purchased with little or no notice of the change of management to its creditors. Afterwards, usually during a seasonal peak such as at Christmas, larger than normal orders are made with the same predictable results, leaving the defrauded merchant with nothing but the commiseration of his fellow competitors who in all likelihood were similarly injured.

"Bustouts" have been prevalent for quite some time but recently they became a money machine for a new type of organized crime—a new type of mafia—in Southern California. Instead of being Sicilian origin, this group shares a Mid-Eastern heritage. Because so many of them emigrated from Israel, they are often referred to as the "Israeli Mafia".

I was not aware of the existence of this group until March, 1978, when I was retained by Lee J. Fortner and K. Richard Kaufman of Credit Managers Association of Southern California. Several retail stores, apparently part of a "bustout" operation, had just closed, causing creditors to lose well over a million dollars. Other retail outlets in Southern California and Arizona were thought to be part of the same criminal operation. Hardest hit were companies in the Automobile and Home Stereo field, Photographic field and Television and Appliance field. They had asked the fraud prevention department of the local Credit Managers Association to take action.

The information we initially obtained was that "bustout" operations along the same lines described had been conducted since about 1975 by a group referred to as the Israeli Mafia, and local law enforcement authorities were unsuccessful in stopping them. We were told that members of this group had cooperated with

each other by allowing their names to be used as credit references and by serving as a conduit through which merchandise from a "bustout" operation would be disposed. We were also advised that in order to prevent their arrest, members of this Mafia had physically assaulted and murdered witnesses. Our source told us that if anyone with the local Association were to investigate this group, he would be a "walking time bomb". I advised Lee Fortner and Richard Kaufman that I doubted we would be in danger since we would be acting only as a conduit for information. In such a setting, our investigation continued.

Our first task was to learn as much as we could from the information already available about the Israeli Mafia, who the members were, how they operated and why they had not been apprehended. We discovered that their principal criminal activities started in Southern California in about 1975. In the beginning, they engaged in extortion activities against Jewish and Israeli merchants in Los Angeles and Calexico, California. These merchants were confronted with the simple choice of either paying money or having their establishments burned. When some of the merchants refused, their stores were destroyed by fire. Other merchants, seeing what had happened, began to pay. In other instances, Israelis living in the United States were compelled to comply with extortion demands because of threats that harm would be done to their relatives still residing in Israel.

Later, we believe members of the Israeli Mafia filed bogus burglary and theft claims with insurance companies, and using the monies from all of these sources, they may have engaged in the illicit narcotics trade. They also moved successfully into the "bustout" type of operations. It is estimated they have "ripped off" merchants in Southern California and Arizona in excess of several million dollars in the past four years.

Our information is that it members may not exceed fifty in number, and that this group operates like a "hydra-headed monster", engaging in different criminal activities without a control center. Although the Israeli Mafia has been known to local law enforcement agencies for some time, no arrests of any consequence have been made primarily because of the refusal of witnesses to come forward. Witnesses have been intimidated by threatening telephone calls, and in some instances, by being physically beaten.

It was patently obvious to Lee Fortner, Richard Kaufman and myself that a civil suit would be of no value. An immediate cessation of the Israeli Mafia "bustout" schemes and prosecution of the perpetrators were our principal objectives. To this end, a select group of involved creditors was formed to assist in the gathering of information. Members of the Credit Managers Association in Los Angeles were asked to provide us with any information of a suspicious nature and were cautioned by us to act prudently in certain situations.

We further called in the FBI and, for the first time, to our knowledge, brought together representatives of the federal and state law enforcement agencies to deal with this problem. Additionally, we acted as an important link between the members of the local association and the FBI so that the investigation would be accelerated and unimpeded. To get the full and active support of the federal law enforcement agencies, we urged members of the respective trade groups to write to Griffin Bell, the U.S. Attorney General, and William Webster, the FBI Director, strongly requesting that action be taken against the Israeli Mafia. Members of the trade groups responded with alacrity and inundated these two offices with letters demanding that the federal government put a stop to this Mafia's activities. I am pleased to say three individuals who apparently were part of this group were arrested and convicted in Arizona. I am informed that the FBI has assigned additional agents to this investigation. Also, by subsequently allowing "word" of the investigation to become public, we believed that members of the Israeli Mafia would cease their bustout operations, and we understand that this has occurred.

This does not mean that the Israeli Mafia is out of business. For the moment they have suspended their bustout operations. However, although more than a year has elapsed since these "bustout" incidences, no further arrests, to our knowledge, have been made.

The "bustout" schemes I have just described are sometimes characterized as a form of "bankruptcy" fraud since they arise from, and are associated with, a company going out of business. The losses from such scams have been estimated to be more than several hundred million dollars per year.

The major problems, as we see it, are three-fold: (1) getting the law enforcement agencies initially to investigate a suspected bankruptcy fraud; (2) obtain-

ing some "feed-back" of the results of the investigation from the authorities; and, (3) causing the law enforcement agencies to prosecute the perpetrators of the fraud.

It has been the experience of most creditors that the local authorities are loathe to become involved in a fraud case involving complicated business transactions.

It is our impression that most local police and District Attorney's offices are geared primarily to deal with violent, highly visible crimes and property so local law enforcement agencies have limited resources and are not as prepared as private civil attorneys to put together a complicated case involving hundreds of documents. The difficulty of showing corroboration for the crime and proving the case beyond a reasonable doubt are restricting factors to any successful local prosecution.

To underscore the problem, it has been said that most investigations of any significant fraud scheme take six months to one year to be completed. Because of the substantial evidentiary items needed to be established, many fraud cases are started through indictments issued by the grand jury. Recently the Supreme Court of California ruled that a defendant indicted by a grand jury is entitled to a post indictment preliminary hearing. While in many cases preliminary hearings are of short duration, such hearings in fraud cases can be quite extensive. Hence the cost of prosecuting fraud cases in California has increased greatly, and I suspect it will now be more difficult to get the local authorities to act.

Because of the apparent limitations inherent in any local investigation and prosecution, most creditors feel that their best chance of convicting persons engaged in commercial or bankruptcy fraud schemes are through the federal government.

Yet when the federal authorities had been called upon for assistance, and if arrests are not made immediately, it appears to most creditors that the investigations undertaken by the government seem interminable. Moreover with no "feed-back" from the authorities as to the progress or lack of progress being made in the investigation, creditors feel frustrated as a consequence. What happens then as a practical matter is that the losses sustained are considered by the creditors as a necessary cost of doing business which is then passed on to the consumer in the form of higher prices.

Whether the problems noted can be remedied by new legislation, such as the granting of additional authority to the trustees in bankruptcy to investigate bankruptcy fraud in no asset estates and the amending of the present bankruptcy fraud criminal statute, or whether the problem can be remedied by an increase in the manpower of the FBI and the Department of Justice are matters that I am certain this committee will consider.

But in the final analysis, unless some further effort is made to arrest the increase in commercial or bankruptcy fraud, creditors, like other private citizens, may lose faith in the system and decide that the only practical and realistic course available is to increase their prices in order to pass the losses sustained from such fraud to the consumer.

Finally, I would like to thank the members of this committee in affording me the opportunity of sharing some of my thoughts and experiences in the area of commercial or bankruptcy fraud.

Senator DeCONCINI. Our next witness will be Wallace Taylor, vice president, Furniture Manufacturers Credit Association.

Mr. Taylor, we thank you for being with us this morning. If you have a formal statement, we will be glad to submit it. We appreciate your association coming forward and helping us in this complicated effort.

We are most interested to hear any testimony you have. However, I would like to direct you, if I could, to some of the hypothetical, or particular cases that you could point out for us, so that we have a good record of exactly what the business community has to face in dealing with bankruptcy fraud.

If you would, please identify yourself and proceed.

**STATEMENT OF WALLACE TAYLOR, VICE PRESIDENT, FURNITURE  
MANUFACTURERS CREDIT ASSOCIATION**

Mr. TAYLOR. I am Wallace Taylor, and I am vice president of Furniture Manufacturers Credit Association, High Point, N.C., and have served as executive director of this association since its beginning.

I would like to begin, Mr. Chairman, and members of the committee, by expressing in behalf of the board of directors and the members, our appreciation for being able to serve as a witness to the work that you are doing. I want to assure you that we will support your activities and help in any way we can. We do know that this is needed badly, and I will try to point out a few points to emphasize our problems.

Mr. Chairman, I did not have a prepared statement, as I was not sure of exactly what would be required. I have a rough outline and I can submit a prepared statement if it is needed.

In order to make my position clear, I would like to give briefly some of the outline of the functions of the Furniture Manufacturers Credit Association, because I think it is pertinent to what we will be discussing.

The Furniture Manufacturers Credit Association is an unusual credit organization. It is a membership organization. It represents the leading furniture manufacturers and factories. Our function is to provide current flow of interchange information in order to help the credit officer to make his decisions in extension of credit. We do have a collection service that works closely with the members only, and in this respect we have worked in many areas attempting to have creditors meetings and committees set up to enable us to work with companies on a rehabilitation basis, endeavor to determine if any irregularities or fraud are involved.

In this respect, we have been certainly able to quickly pick up fraud cases or indications of fraud, and I want to specifically review factually certain cases that we have had. One is Tippens Furniture and Appliance Co. in Chattanooga, Tenn. This company has been operating with a reasonable credit rating for a number of years, and two principals came in; namely, men by the names of Cunningham and Dunlap, they walked in with a briefcase and just told the owner of the business that they understood the business might be purchased.

They were only anxious to purchase the capital stock of the corporation, not the inventory, because they knew if they purchased the inventory it would be a bulk sale transaction. They opened the briefcase after only verbal figures were given, and paid \$100,000 for the business. They promptly got on the telephone and called and placed orders close to a million dollars, and this company then proceeded to sell the merchandise out through various avenues, trucks, fairground operations, in Knoxville, Tenn.; Nashville and Memphis, and we were fortunate in being able to quickly determine that we had fraud involved.

We were successful in working with the Federal attorney and with the FBI and because of the promptness of our action, we were able to at least obtain or at least get part of the merchandise. However, over \$700,000 in merchandise was sold in the period of 60 days. This case finally was resolved by these two principals being indicted and convicted and subsequently sentenced.

However, the loss to the manufacturers was quite substantial as there was only about 10 percent return from the merchandise that we were able to find. Some of this merchandise was as far away as Tampa, Fla., stored in a warehouse near the airport.

One other case that I feel will be helpful to review. We had a case by the name of P. & P. Wholesale Co., in Ponotoc, Miss. It was supposed to be a partnership. The principals were Billy Parker and Ruth Parker. This company sent out financial statements and proceeded to buy merchandise. As the merchandise came in, they were able to move it by truck to various areas and dispose of it in opening up stores or selling it from the tailgate of trucks, and this expanded to Mississippi, Florida, Alabama, and Texas. So it was a widespread operation.

We know that better than a million dollars in merchandise was moved through this area. We were a little late getting the information. We attempted to work with the FBI and relayed all the information we had. However, we were never able to successfully—we filed a petition in bankruptcy. However, the petition was dismissed, and we then filed a receivership. We did get one of the parties under the receivership, but the receivership is still pending.

We have not been able to finally obtain the necessary help, although we used all of our fraud fund in trying to pursue this matter. It became a rather large operation after the merchandise was turned into a case—and the party went to Houston, Tex., attempted to open there, and a subsequent, very disastrous fire occurred—which never was finalized, and we feel like if we had had some help from the Federal authorities, we would have been able to certainly indict and convict this party.

The party is now operating another business, and, of course, we are watching this business carefully. From the information, hopefully, he will not be able to pull the same thing over again.

We had one other case, Factory Surplus and Freight Sales in Little Rock, Ark. We were able to obtain very excellent counsel, an attorney from Memphis, Tenn., and we also, because of the promptness of our communications from our members and through the interchange, could determine that this certainly was going to be what we call, maybe not a bustout, but a rip off. As well as we could determine, there were five principals involved. The leading two was a man by the name of John Slingerland, and another one, Bob Wilson.

They all had used numerous aliases in communicating with creditors and people that they dealt with. We were able in this case to get the judge to immediately appoint a trustee which is very unusual. One of our big problems in bankruptcy has been, you file an involuntary petition, and it takes so long for the first hearing to occur, that you have a real weakness here because so much of the damage can be done, the assets disappear and so forth, before you can put it under the custody of the court.

We were able to get this trustee and we found by very close work and some help from the FBI, in this case we had a Federal attorney that gave us a great deal to help, we were able to locate a substantial portion of the merchandise, and we did make a fair recovery, and we were able to get indictments and convictions on three. However, while the process or while the appeal was pending, Slingerland managed to

go to Birmingham and under an assumed name rip off the creditors again.

We have been involved with these cases and numerous other cases in all levels of what we would say are organized crime. I listened closely to the previous witness you had, and I certainly know the serious problem that can occur in major organized crime, but I would like to point out to this committee that we have several different levels of organized crime.

One of our problems has been in a group that is called simply liquidators, but they are organized and they have been able to continually build up their organization and they splinter off and go to different areas, setting up the same type of an operation. They are well informed as to how they can skirt and use our laws for protection, such as avoid bulk sales, avoid anything that might quickly bring it into court. They use every means of obtaining credit, such as going to the marketplace and handing out statements, trying to avoid mailing the statements through the mail. They will go into a company and try to take it over or else they will set up a company and a name and prepare to establish a credit rating that they can buy, and in this area they are able to quickly obtain merchandise. Then that merchandise disappears, is taken out to different areas, and before you realize it the company is completely insolvent.

We have a case at this particular time that we have just filed an involuntary petition on, Corry Furniture Company, Pensacola, Fla. There are two principals involved. One is a man by the name of Mack Daw and Lester Perkins. We know they were both previously connected with a firm in Houston, Tex., and Daw has been indicted. We believe from our legal counsel that Perkins will be indicted.

We know that merchandise from the Houston area has moved, and we are trying to locate and find out if any of it is in this particular bankruptcy case here. But this is another case where these two parties talked the owners into allowing them to run a so-called liquidation sale, but, obviously, it would turn into the same type of rip off.

Now we feel that the present Bankruptcy Act is going to help in one respect, but there are many areas that I feel the work is being handled, or at least the plans that I understand this committee is working on, to increase the machinery for handling fraud cases, could certainly benefit us a great deal.

We feel more attention should be given to the creditors' committees that can be formed so the avenue of information can go forward to the Federal authorities where necessary. We feel that we need not only the FBI, but we need the post office authorities and the Internal Revenue Service.

In my experience over the years, the manufacturers have taken very substantial losses from these fraud cases. They obviously are able to charge these losses off to bad debts. However, those parties that pull these rip offs and sell this merchandise, obtain cash and never report it. This is at a very serious loss. We feel in almost every case that I have been involved with that this is certainly one area that might be very helpful in coping with the problem.

We as an association attempt, as I said in the beginning of this talk, we attempt to educate the credit officers, we attempt to make

available the avenue for good companies to come to the association in a cooperative effort if they have problems. We also feel by doing this, we are able to continue the avenue of communication, whereby we can quickly obtain the information on so-called rip offs, bustouts or fraud, and then by working with those creditors, this information comes together and we are able to turn this over to the Federal authorities where necessary, and we believe in this combined effort that we can attack, shall we say, the organized crime from all levels. If we break it out while it begins on these smaller operations, it is going to further hamper the increased size and the increased dangers that have been pointed out by the previous witness.

This is my report to you, Mr. Chairman, and, again, I want to offer our full cooperation in any way we can.

Senator DECONCINI. Mr. Taylor, thank you. On behalf of the subcommittee, let me express our appreciation to some of the details you have gone into.

Let me ask a couple of general questions. You have pointed out the problem very distinctly. A couple of things come to my mind. Is it your experience that members of your association are willing to get involved in the investigations? Or do they often shy away from it because of either the time involved or because of the potential intimidation?

Mr. TAYLOR. I would say that because of the education and discussions we have had over the years with the association, our members are more willing to become involved and to work in this area. The only problem we have, and it is a serious problem—I mentioned during my talk that we had a fraud fund—they are reluctant to take any additional losses in their companies, as you can appreciate. This is where we do need the Federal authorities, we do feel like this is the help I stressed during my talk, the value of creditors' committees. The committee work is educating the credit executives of the importance of continuing and also to supporting an effort of this kind.

For a long time at the beginning, I faced exactly what was discussed earlier: reluctance, because we can't accomplish anything, no one will do anything. However, we have shown by some of these cases and I have countless others that I will make available to counsel for the committee or go into detail on the work we have done to wipe out some of these bad situations.

The help that I have and the willingness to cooperate has clearly been shown and I think that answers the question.

Senator DECONCINI. Is it safe to say that you feel that more emphasis should be placed on this type of enforcement from the Federal agencies? Is it your feeling that there is not enough in enforcement resources on the Federal agency or is it the fact that the cases are very complicated and take a long time?

Mr. TAYLOR. If I may answer that by making available to you some of my past experience.

Senator DECONCINI. Please.

Mr. TAYLOR. At one time I had excellent communication with the Chief of the Fraud Division, Department of Justice, back a number of years ago. Because of two or three cases we had during that time, and I could not get the local authorities to move, I was able to com-

municate directly with the Chief, explain what we had found and not the full evidence, but it showed that certainly we had enough information that would justify quick action, and I would get results.

Following his retirement and a little lessening of this cooperation, steadily existing, I have lost that completely, and I am running into the position now that I find, they say, we don't have jurisdiction or some excuse that I cannot get the support.

I feel strongly that this certainly should be emphasized to the point that we can have some avenue, and I think this committee can help us in this respect. Where do we go to get this? What can we do? We will give you all the help we can.

Senator DECONCINI. Indeed you are giving us some help. Is it your experience that members of your association have come across elements of organized crime that are involved in this and just how extensive do you think that the Mafia or the LCN or other criminal activities, are into this? Or do you think it is a local organized crime problem or more of a national one?

Mr. TAYLOR. I tried a little earlier to make somewhat of a comparison of different levels of organized crime. I have been directly involved in high level, if you wish to say, Mafia crime, and I feel like that we were very instrumental in this particular case in rather quickly getting an involuntary petition in bankruptcy filed and beginning to lessen the flow through the court proceedings of the goods that kept feeding the company.

Now I think this, in my opinion, is what needs to be considered. It is going to have to be attacked from all these different levels, because as these smaller groups are organized crime, they tend to expand.

I have one case that I followed closely, beginning, I am confident—the beginning of this ring started in Pensacola, Fla. The next appearance was Indianapolis, Ind. They set up a wholesale operation. It disappeared overnight. They hit three places in Tennessee. The next thing I knew they were operating right under my door in Greensboro, N.C., and they went on down through Georgia, and I did finally force the leading one by the name of Elmer Dean Gietens to personal bankruptcy, knowing full well from all the cases that certainly a lot of cash was there. He declared himself a pauper. He is now operating in Alabama, and we are watching this case.

My own accomplishment in this case, if I may burden the committee with it, is that I was so frustrated I found out he was a very avid golfer, so I reached the end of my rope, but I did find out he was playing in a member guest golf tournament, so I had my attorney, with an excellent marshal, to find the starting time and so we attached the golf clubs, his shoes, and his money, and at least we ruined his one day.

Senator DECONCINI. That might have hurt him more than anything else.

Mr. TAYLOR. I felt like this might give you a little laugh.

Senator DECONCINI. Thank you for that sidelight. Thank you very much, Mr. Taylor.

Mr. TAYLOR. Thank you.

Senator DECONCINI. The next witness is Mr. Ed Pryor of San Jose, Calif. Please identify yourself, and proceed with your testimony.

#### STATEMENT OF ED PRYOR, SAN JOSE, CALIF.

Mr. PRYOR. My name is Ed Pryor. I appreciate having the opportunity to appear before you this morning. I am appearing on my own behalf as a member of the credit community. I am not representing any company per se. My background includes credit within the industrial manufacturing area, as well as 9½ years of progressive employment in the credit reporting agency of Dun & Bradstreet. I have had both sides of the fence and I am one of the guys in the trenches at the moment.

I was listening to the gentlemen this morning, and a couple of things did come to my mind during those conversations. We certainly in the credit community appreciate the efforts by the credit reporting agencies and the different credit associations, and the efforts that they put forth on our behalf. I do believe in this particular area that we are discussing this morning that the major responsibility lies and rests with the credit management of the individual firms. Certainly, I could have an overbuy situation sometime in the future. I have had numerous overbuy situations come across my desk. So far I, myself, personally have never been burnt. I believe the reason for that is because I have conducted a thorough investigation on behalf of the organizations that I was employed with or am employed with now.

I subsequently find out that they were overbuys, and the actions that most overbuy situations take or how they go about an overbuy, I don't believe that organized crime as such is the major problem. It certainly is a significant problem, and when organized crime is involved, you are talking about significant amounts of money. However, more often than not, the overbuy situation never reaches the bankruptcy court. It is a company, as an example, located in New York, they overbuy with companies located in Chicago or San Francisco or Los Angeles, and they just go out of business and they never reach the bankruptcy courts.

So we have some particular concerns in the credit community from that particular regard, because it in effect is a bankruptcy or insolvency fraud, it just never reaches the Federal courts. And the companies that lose the money find it much more prudent to just write it off to bad debts than to pursue it any further. I think that is my basic opening comments, if you will, and I will leave it to your discretion what you would like to know.

Senator DECONCINI. What is the threshold, would you say, Mr. Pryor, where a creditor is apt to go on and not write it off?

Mr. PRYOR. You asked that question from one of the witnesses a little earlier this morning, and it was an answer that tracks record performance and when do you increase the credit, and I think the answer was generally in 6 months. I never increase credit without knowing the reason for increasing credit. I do not increase credit just because I have had previous bills paid. I think Grant and Penn Central is an example of that.

Senator DECONCINI. Let me give you an example. If you were in the toy business, and you picked up a company, say, in January, after the Christmas holiday, they were a good pay for 8 or 9 months, and then come October or November, they doubled their buys from you, would you investigate them?

Mr. PRYOR. Well, I always have continuing an ongoing investigation with all of our customers. But it is not a static field. What is today is not tomorrow. A very good company today, they may tear up the street in front of the retail location for 6 months to put in water sewers, and they don't have any traffic going by, and they go out of business.

Senator DeCONCINI. Getting back to my first question, you made some reference that there are lots of times a business is reluctant to pursue the loss, by going to law enforcement, if they think there is some criminal activity. Is there any experience you have had that would give you any estimated amount of how many instances of this there are?

Mr. PRYOR. I think it is a case-by-case basis. In my particular case, if I was burnt by an overbuy, I guarantee I would go the route and I would have the full support of the organization.

Senator DeCONCINI. Regardless of how much?

Mr. PRYOR. Regardless. If I believed that a criminal activity took place, I would go the entire route. Now I have been involved with law enforcement because of things that happened before my time with organizations or because of my experiences when I was with D. & B., and I would say law enforcement as I perceive it, is totally cooperative. In my experiences I have had total cooperation, and I think it is because I am on an individual basis representing an individual company. I can't make reference as to why credit associations may have problems with law enforcement as far as getting feedback. I get feedback by picking up the phone and saying where are you at? And I demand an answer.

Senator DeCONCINI. Do you have an opinion, do you think business sometimes looks to law enforcement to collect their debts, as well as to do the fraud investigation?

Mr. PRYOR. I don't think so. I think business as a general rule, they have already written that off. They are not as interested in collecting the debts as insuring that they are not going to lose in the future.

Senator DeCONCINI. You find with your experience in your own company and other associations that generally business is willing to move forward on a criminal complaint. You don't find a reluctance?

Mr. PRYOR. I am sure there is a reluctance to some extent. I cannot categorically say that business will go out and spend \$50,000 or \$100,000 to put somebody behind bars because they lose \$500. I think there has to be some type of rule of thumb, if you will, and that rule of thumb, I can't tell you; it is on an individual basis. But how much money would you spend? Who knows?

Senator DeCONCINI. How big a problem is this overbuy in the electronics business? Do you have any estimates or any opinions of what the magnitude is?

Mr. PRYOR. I think from the point of view of my experience in the electronics industry that it is a young industry, that it is branching out in a lot of consumer areas, and that are unknown to the management, if you will, of the industry as a whole. And they have had occasions to lose money, certainly because of the overbuy.

I can't put it in dollars and cents. I have no idea.

Senator DeCONCINI. In your particular geographical area, is it substantial? Is it thousands of dollars or millions of dollars; or do you have any idea?

Mr. PRYOR. I don't think I would want to put a price tag on it. If it is happening in the industry, it certainly would have to happen in the valley, because we are the industry.

Senator DeCONCINI. We are talking about law enforcement involvement. Has your involvement been with local law enforcement or Federal?

Mr. PRYOR. Both.

Senator DeCONCINI. What kind of response did you get from both?

Mr. PRYOR. I think that on an individual basis and how they want to proceed, they certainly have the interest and concern. However, I do believe that particularly recent legislation, and I mean recent within the seventies, law enforcement is continuing to be hampered in their investigations, in this area, as well as in every other area, because of the constraints that have been put on law enforcement.

Senator DeCONCINI. You mean constraints by the law?

Mr. PRYOR. By the law, and certainly from an investigative point of view.

Senator DeCONCINI. What about resources; do you think there is adequate resources?

Mr. PRYOR. Everybody wants more money and more people.

Senator DeCONCINI. Thank you very much, Mr. Pryor. I have no further question. We appreciate your testimony.

Mr. PRYOR. Thank you.

Senator DeCONCINI. Our next witness will be Homer Bonhiver, certified public accountant from Minnesota.

Mr. Bonhiver, we are very pleased to have you here today. We want to pay particular thanks to Judge Miles Lord for putting us in contact with you, and recommending you highly for your involvement in this area. So we look forward to your testimony. Please proceed.

**STATEMENT OF HOMER BONHIVER, CERTIFIED PUBLIC ACCOUNTANT, MINNEAPOLIS, MINN.**

Mr. BONHIVER. Thank you, Mr. Chairman. I would like to emphasize at the outset that I am not an attorney. I am not a government employee, but a semiretired, independent, certified public accountant. The reason I want to emphasize that is because I have found over the years that my involvement in this area seems to be unique in terms of activities of members of our profession. To me this is a very important point and one of the crucial ones, I think, as a matter of fact, regarding the problems that are being discussed here.

By way of explaining my background, I would like to read a statement to you, Mr. Chairman.

In 1950, I received a business administration degree from Northwestern University, and my initial CPA certificate from the State of Illinois. Up until 1965 I was a senior partner in a Minnesota CPA firm. I have also served 7 years on a Minnesota State Board of Accountancy, which is the board that examines and controls the profes-

sion in our State. The final year I served as chairman of that board.

Since 1960, however, I have been continuously retained by, or involved under special assignments in behalf of various levels of the government in the court system. This has included service for four Minnesota attorneys general, the Minnesota Senate, county attorneys of the State, the U.S. district attorney, State and Federal courts, the Internal Revenue Service, Department of Justice, and in more recent years the bankruptcy courts.

Positions I have held during this time include those as investigator, as conciliator, adviser, legislative assistant, accounting expert witness, member of creditors committees, receiver, operating receiver, receiver with limited powers, and trustee, and within recent months as a panelist and author concerning application of the new bankruptcy law.

Entities involved over these years have been a national charity, insurance companies, banks, shopping centers, buying clubs, real estate holding companies, professional persons, a large investment brokerage, a paper supply company, a national real estate trust, and a State chain of motels.

Although the charitable organization and the insurance companies were the most spectacular cases I work on, because of political overtones involved, in each instance substantial amounts of money and other assets were taken, withheld or diverted from rightful owners or beneficiaries.

In every case that I have been involved in there were not only technical violations of law, but varying degrees of deliberate fraud. Many, if not most, of these legal violations quite likely would never have been discovered if the insolvent condition of the entity had not triggered more careful scrutiny by outside investigators or accountants. As a result of having spent more than 19 years now in this field of special investigations, I am convinced that violations of law and planned fraud are common ingredients in a vast majority of business insolvencies and bankruptcies, particularly large ones.

The relatively few cases which are discovered and publicized in my opinion are only the tip of a very massive iceberg. Bankruptcy laws have provided very little encouragement, incentive or support for the prevention or discovery of fraud or for any effective followup, even when clues do present themselves. On the contrary, the shield that was intended to protect innocent debtors who need and who are entitled to the cloak of the bankruptcy system is regularly used by crooks. As a result, they end up with private protection and a security guard system which not only has the full force and dignity of the U.S. Government behind it, but which costs them nothing.

The bankruptcy proceeding has been likened by one prominent Minnesota attorney judge to "a great black hole in space, a void into which any living thing or any planet just disappears." Another one described it as being like a lemon: "All the juice is squeezed out by participants, and creditors are left with a limp rind."

While these may be too severe descriptions of many bankruptcies, my own conception is that like a police station being placed in the middle of a blighted area to protect those who need and deserve protection.

The station is used instead as an escape route for criminals; who

have the victims hot on their trail. The police slam the doors in the face of the victims, and even to the extent of ignoring blood on the hands of these criminals, let them escape with their loot safely out the back door, to have them repeat their acts on down the street again.

I believe that the Bankruptcy Reform Act of 1978 has improved the potential for bringing fraudulent situations under control, particularly in those districts where there are U.S. trustees. Unless these trustees develop much more comprehensive programs of examination and follow up on fraudulent acts, and unless there is more cooperation from the FBI and the district attorneys, I feel that very little will actually be done to bring this vast and growing cancer in our economic system under control. Unless the bankruptcy law and rules regarding fraud are expanded and clarified, there will likely never be a good and consistent national pattern for containing white-collar crimes.

I have prepared a summary of what I think is a definition of the problem areas. Perhaps a copy of it has been placed in your hands, Mr. Chairman.

[The definition of problem areas and recommendations for law changes follow Mr. Bonhiver's prepared statement.]

Senator DeCONCINI. We would be glad to insert that in the record. Mr. BONHIVER. Thank you. I believe the problem can be pretty well summarized as regards the bankruptcy systems with seven points.

First of all: Virtually nothing is being done to assure that the debtor who seeks protection of the bankruptcy court comes in with clean hands.

Second: Very little is being done to determine whether there is even a possibility that some fraud has been committed before filing of the petition.

Third: Some of the jurisdictional problems have been eliminated by the Bankruptcy Reform Act of 1978. But the trustee is still restrained and burdened by unrealistic statutes of limitations.

Four: There is inadequate accountability at crucial steps in a bankruptcy proceeding.

Five: Debtors are carelessly permitted to continue in possession without any credible showing that they deserve this right to control assets, which actually belong to the creditors.

Six: There is no appropriate motivation for any trustee to examine or challenge claims by creditors or more importantly to pursue indications of fraud, either by the creditors or the debtor.

Seven: There is no effective followup system to assure the U.S. trustee or the trustees in the case that the FBI, the Treasury Department, or any other agency of the Government, or the district attorney are pursuing reported fraudulent acts.

I also have a list of what I feel are what would appear to me to be pertinent suggestions concerning the strengthening of the laws. Before I get into that, though, Mr. Chairman, I would be glad to expand on any of the points that I have just mentioned if you have questions you would like to ask regarding any of them, and then I will get into summarization at the end.

Senator DeCONCINI. I am looking to your suggestions there and maybe you will cover that.

You mention a number of real problem areas. One of them is trying to assure that those that are going to file in the bankruptcy court come in with clean hands. How do you think that can be done? Do you have any suggestions or have you given any thought to that?

Mr. BONHIVER. Yes, I have. There are, of course, many things that can be done, but specifically I believe that any debtor coming into the bankruptcy court should be required to state at that point whether he has been involved in any fraudulent transactions since he first became insolvent.

Second, I think that he should be required to file a statement at that time, not only of his financial condition when he goes into bankruptcy, but also a statement as of the date when he first became insolvent; and that is important as I will get into further along in my suggestions here.

I do feel that—well, the next step is that he should be required to list all transactions he may have had with close relatives, for instance, that being relatives defined by Internal Revenue Service Code; transactions that occurred since he first became insolvent.

I believe also that when he comes into bankruptcy, he should really be putting himself in a sense at the mercy of the court. He has come there voluntarily. The court is there to protect him. He should be willing to make a clean presentation of everything that has happened.

Further he should at this time be expected to waive any defenses of statute of limitations concerning any acts of his that may have occurred, at least as far back as the beginning of his insolvency.

If these points were all required of him at that point, a creditor who was not honest would be discouraged from coming into the bankruptcy system.

Senator DECONCINI. You also mention, Mr. Bonhiver, the lack of motivation for the trustee to examine or challenge the claims by creditors or to pursue fraud, either by a creditor or debtor. How do you think that could be corrected?

Mr. BONHIVER. If I were asked the major weakness and the most critical flaw in our whole bankruptcy system, I would say this is it. The trustee is the key person, the one who really should be zeroing in on not only clearing up everything that has happened as far as bankruptcy is concerned, but he also should be the one that pursues possible fraud activities of the debtor.

Yet the way the system is set up now, there is absolutely no incentive for him to do it. Instead, he is constrained, bound by the schedule of fees, which is measured not by how good a job he does, how thorough a job he does in behalf of the creditors; it is measured only by the amount of dollars that go through his hands.

As a result, the practice, the common practice—because I deal with an awful lot of trustees over the years—the common practice and attitude is to simply get their hands on the cash that is easily available, convert assets to cash as rapidly as they can be converted, and forget everything else, because that is how his fees are determined.

It is not determined by what kind of job he does in questioning transactions. It is not determined by his examination of the claims or by any other of the extremely important efforts to either work in behalf of the creditors or go after fraud situations. Any work he does in

that regard, work he does as an expert witness, for instance, he is not even paid for it.

Senator DECONCINI. That is a very good point. I think we need to address that. I am glad you explained it so explicitly.

Go ahead, if you want to finish your testimony.

Mr. BONHIVER. I might go through the other points and explain them here a little further, if it is satisfactory.

Senator DECONCINI. Certainly.

Mr. BONHIVER. The second point I made was that very little is being done to determine whether there is even a possibility that some fraud has been committed before the filing of the petition. At present there is no requirement that there be anything more than a cursory examination of the creditor when he comes into bankruptcy.

There is no provision that there is a financial analysis, and, of course, my main concern is in business bankruptcies. I should point this out. I have not been that involved in personal bankruptcies, excepting when there may be a business involved. But at present, there is no requirement that there be even, as I say, a cursory determination that there may have been some fraud committed. I believe that there should be some form of examination in every business bankruptcy before it is permitted to proceed to give the trustee an idea of whether there is more that meets the eye.

The third point I mentioned here is that there should be more support of the trustee and his efforts in pursuing appropriate actions by relieving him of the burden of unrealistic statute of limitations.

The trustee is burdened with an awful lot of things the way it is when he comes in. Yet it is a completely new situation for him, and to still have him be faced with time limitations for going after improper transactions is completely unrealistic, as I have said. I believe that there should be little or no restrictions as far as statute of limitations are concerned.

The fourth point, I have indicated there is inadequate accountability at crucial steps in the bankruptcy proceeding. This gets down to the point of there really being very little involvement of accountants at any stage of bankruptcy proceedings.

I do feel that the new law is encouraging more involvement. As a matter of fact, Mr. Chairman, I was recently engaged by one of the big eight CPA firms to prepare a manual for them to be expanded and used by the entire CPA profession, introducing and describing ways in which the new law does open up new avenues for accountants to be involved in bankruptcy proceedings. Based upon my experience over the years, I feel that this is the only way business bankruptcies, business frauds are ever to be brought under control, really. And that is by having considerable more involvement on the part of accountants, accountants who are able to develop cases so that when the facts are presented to a jury or to a judge they are concrete enough and understandable enough to bring about convictions and enforcement.

This is one of the tremendous problems in frauds, and that is, it is difficult to prove that a fraud was committed unless there is a lot of basic work done in preparation for the trial and in preparation to serve as witnesses.

If I may, I would like to read the chapter of that manual which I believe describes involvement that I feel accountants should have in this activity:

On November 6, 1978, President Carter signed into law the Bankruptcy Reform Act of 1978. The result is reorganization of the Federal court and a new pattern of activity within the bankruptcy system. Up to now, involvement of independent accounts in bankruptcy proceedings has been very limited; for that matter, so has involvement of most attorneys. Various roles in the administration of bankruptcies have generally been filled by a relatively small and closely knit group of attorneys who move from one chair to another, often within the same proceeding.

The need for good accounting and investigative efforts beyond what these attorneys have been able or willing to provide has been largely ignored, except where pressure has been applied by SEC or some other regulatory agency or by an organized group of creditors.

With the rapid growth in the number of business bankruptcies, an acceleration of this pace during the period of recession, it has become apparent that activities in this field have become a significant factor in our economic life. Billions of dollars are involved and almost everyone is affected at sometime by the bankruptcies of various businesses.

Yet, relatively little has been done to extend comparable standards of accountability which have been established in normal business relationships to activities after the filing of a petition in bankruptcy. Too often ignored is the fact that even though a business may have become insolvent and unable to meet obligations as they fall due, there can still be substantial available assets, both tangible and intangible; frequently included in these assets are choices in action which are personal rights not reduced to possession, but recoverable by a suit of law, which can and should be pursued against insiders and favored creditors.

Many of these assets can be adequately identified and pursued through appropriate legal action only when there is reliable and responsible accounting. Under the new law there will be an even greater need for assistance from outside accountants. In an attempt to reduce delays and offer decision-making authority to creditors and to the court, the right of SEC to enter into a case as a party in interest has been eliminated.

SEC will still be permitted to appear and raise and be heard on any issue, but will not be able to appeal from any judgment, order or decree entered in the case. Value judgments and interpretations of investigative reports will rest much more heavily on the shoulders of the bankruptcy judge.

The creditors themselves or their representatives will be expected to pursue their rights to recover, restore, and otherwise protect assets which actually belong to them, and to arrange for effective presentation of their position. Only through the use of competent accounting assistance can the trustee and/or attorneys adequately represent them in hearings before the court.

To carry out their expanded responsibilities, everyone and particularly bankruptcy judges, will need reliable accounting and financial reports. A vast new challenge has been placed on the doorstep of the accounting profession. There are many ways in which members of the profession can respond to this challenge. This manual identifies roles in the bankruptcy procedure which can be filled by accountants.

In addition, much remains to be done in the development of uniform accounting and reporting, and in investigative procedures and standards. Various portions of this manual identify the need for accounting assistance and specific legal requirements section of the law which may be of particular concern to accountants or reproduced in the appendix.

This is not intended to be a legal treatise but only a presentation of accounts' perspective of various significant legal requirements. As is emphasized throughout the manual, where there is any question or doubt, the accountant must seek advice of qualified attorney.

In order to serve effectively, however, it must be recognized that the entire bankruptcy proceeding is really a continuous court case. Everything must, therefore, be done in strict compliance with the law. No accountant should ever attempt to serve without preparation or reliance on advice of legal counsel.

Beyond that the accountant must be ready to make his opinion and his findings part of the court record. He frequently will be the principal witness in hearings

and trials. Most important decisions will be made by the court only after considering the accountant's report and testimony. In most respects, he will be considered a friend of the court, who is there to help the court gain a clear picture before making a decision. The judge will understand and appreciate the extraordinary circumstances under which the account must perform his work and the law plus accountant's own description of his limitations on his opinion will reduce his exposure to personal liability, assuming he does his work conscientiously, competently and testifies forthrightly.

That is the prefix to the manual, Mr. Chairman. That is being developed for use in our profession.

Senator DeCONCINI. Let me go to one other area before we go on to the next witness. You mention as one of your problem areas that there is a lack of a followup system to assure that the U.S. trustees or trustee in the case that the FBI or Treasury Department, or other agencies, including the district attorneys, are pursuing the report fraudulent act. Can you give me a little bit of experience that you have had where you feel that this has not been followed up?

Mr. BONHIVER. Well, I think it is pretty generally accepted by trustees and even judges in trust relationships, that unless you have a really major case, it is futile to turn it over to the district attorney.

Senator DeCONCINI. Why do you think that is, because they have other priorities and don't have the resources, because it is too complicated or what?

Mr. BONHIVER. I guess only they can answer that.

My answer to that, however, is that this is one of the reasons why the system itself has slipped to what it is. It isn't even possible for trustees that want to do a thorough job to do it. I found this from my own experience.

Senator DeCONCINI. They don't have the resources to do some of these investigations?

Mr. BONHIVER. It is not—the trustees may have the resources. They may be able to generate them. But the district attorney and the FBI are not really interested in following up, I have found, on matters that while they may be extremely important to the trustee, they are not considered important enough to devote time and effort to it. Now, as to how they make their standards on this, they will have to answer that.

Senator DeCONCINI. In your practice and involvement, have you experienced fraudulent bankruptcies that you believe are associated with what we term as organized crime?

Mr. BONHIVER. I don't believe we have as much in our area as in some parts of the country. That is activities of organized crime. The closest I have come to that is in an insurance receivership that I handled for a number of years. That, I think, showed some very strong signs.

My feeling, however, though, is that it is a mistake to concentrate just on what organized crime is doing. There is a massive amount of fraud going on that has nothing to do with organized crime, and not only that, it has created a disrespect for law. So much so that some of the most respected people in the community, outstanding members of law firms, accounting firms, professional people have been guilty of ignoring bankruptcy laws and when they are cornered on it, come up with the answer, "This is the accepted practice. I don't care what the law says. This is what is going on. Therefore, that is what I do."

As I say, I don't think there is—there is probably hardly a single bankruptcy, major bankruptcy that doesn't have elements of fraud in it. It is just a matter of degree, and the degree is considerably greater than most people realize. In the cases I have been involved in, it goes into hundreds of thousands and millions of dollars in relatively small bankruptcies where there has been misappropriation of funds that was not necessarily connected with organized crime.

Senator DeCONCINI. Mr. Bonhiver, thank you very much for your testimony this morning. You have been very helpful in pointing out some areas that we need to make to take corrective measures.

Mr. BONHIVER. Thank you.

[The prepared statement of Mr. Bonhiver follows:]

PREPARED STATEMENT OF HOMER A. BONHIVER

My name is Homer A. Bonhiver, I am not an attorney, I am not a government employee, but a semiretired, independent, certified public accountant from Minneapolis, Minn.

In 1950 I received a master of business administration degree from Northwestern University and my initial CPA certificate from the State of Illinois. Up to 1965 I was the senior partner in a Minnesota CPA firm. I have also served 7 years on the Minnesota State Board of Accountancy—the final year as chairman.

Since 1960 I have been continuously retained by, or involved under special assignment in behalf of various levels of the government and the court system. This has included service for four Minnesota attorneys general, the Minnesota senate, county attorneys, the US district attorney, State and Federal courts, Internal Revenue Service, the Department of Justice and, in recent years, the bankruptcy courts.

Positions I have held include those as investigator, conciliator, advisor, legislative assistant, accounting expert witness, creditors' committee member, receiver, operating receiver, receiver with limited powers, trustee, panelist, and auditor.

Entities involved have been a national charity, insurance companies, banks, shopping centers, buying clubs, real estate holding companies, professional persons, a large investment brokerage, a paper supply company, a national real estate trust, and a nine-State chain of motels.

Although the charitable organization and the insurance companies were the most spectacular, because of political overtones, in every instance substantial amounts of money and other assets were taken, withheld or diverted from rightful owners or beneficiaries. In every case there were not only technical violations of law but varying degrees of deliberate fraud.

Many, if not most, of these legal violations quite likely would never have been discovered if the insolvent condition of the entity had not triggered more careful scrutiny by outside investigators or accountants.

As a result of having spent more than 19 years in the field of special investigations, I am convinced that violations of law and planned fraud are common ingredients in the vast majority of business insolvencies and bankruptcies, particularly large ones. The relatively few cases which are discovered and publicized are, in my opinion, only the top of a massive iceberg.

Bankruptcy laws have provided very little encouragement, incentive or support for the prevention or discovery of fraud, or for any effective followup even when clues do present themselves. On the contrary, the shield that was intended to protect innocent debtors who need and are entitled to the cloak of the bankruptcy system is regularly used by crooks. As a result, they end up with a private protection and security guard system which not only has the full force and dignity of the U.S. Government, but which costs them nothing.

The bankruptcy proceeding has been likened by one prominent Minnesota attorney to "a great black hole in space, a void into which any living thing or even any planet just disappears."

Another one described it as being like a lemon "all the juice is squeezed out by the participants and the creditors are left with the limp rind."

While these may be too severe descriptions of many bankruptcies, my own conception is more like that of a police station placed in the middle of a blighted

area to protect those who need and deserve protection. But the station is used instead as an escape route for criminals who have their victims hot on their trail. The police slam doors in the face of these victims and even to the extent of ignoring blood on their hands let the criminals, with their loot, safely out the back door to have them repeat their acts on down the street.

I believe that the Bankruptcy Reform Act of 1978 has improved the potential for bringing fraudulent situations under control, particularly in those districts where there are U.S. trustees. Unless these trustees develop much more comprehensive programs of examination and followup on fraudulent acts, however, and unless there is more cooperation from the FBI and district attorneys, I fear that very little will actually be done to bring this vast and growing cancer in our economic system under control.

Unless the bankruptcy law and rules regarding fraud are expanded and clarified, there will likely never be a good and consistent national pattern for containing white collar crimes.

Attachment.

DEFINITION OF PROBLEM AREAS

1. Virtually nothing is being done to assure that the debtor who seeks protection of the bankruptcy court comes in with clean hands.
2. Very little is being done to determine whether there is even a possibility that some fraud has been committed before filing of the petition.
3. Some of the jurisdictional problems have been eliminated by the Bankruptcy Reform Act of 1978, but the trustee is still restrained and burdened by unrealistic statutes of limitation.
4. There is inadequate accountability and reporting at crucial steps in the bankruptcy proceeding.
5. Debtors are carelessly permitted to continue in possession without any credible showing that they deserve this right to control assets which actually belong to creditors.
6. There is no appropriate motivation for any trustee to examine or challenge claims by creditors or to pursue indications of fraud, committed either by creditors or the debtor.
7. There is no follow-up system to assure the U.S. trustee or the trustee in the case that the FBI, the Treasury Department or any other agency of the government—or the District Attorney are pursuing reported fraudulent acts.

RECOMMENDATIONS REGARDING CHANGES IN LAW

Bankruptcy court is a court of equity. To come into equity, all parties must come with clean hands—with hands shown on table—not concealed in pockets, and be willing to subject themselves to consequences of any actions which led to filing of petition.

Bankruptcy law and rules should be expanded as follows:

1. Debtor should be required to state whether he has been involved in any fraudulent transactions since he first became insolvent.
2. Debtor should be required to designate the date on which he believes he became insolvent, and provide a financial statement as of that date.
3. Debtor should list all transactions with close relatives—as defined by Internal Revenue Service Code—since debtor became insolvent.
4. Concerning any actions of debtor since becoming insolvent, which reduced net assets available to creditors, debtor should automatically waive any statute of limitation defenses until he is discharged.
5. Concerning any creditor who files a claim in this proceeding, the creditor should automatically waive any statute of limitation as defense against any action which caused or contributed to decrease in net assets available to creditors.
6. A preliminary report should be required of the U.S. trustee providing:
  - a. A tentative list of assets at liquidating values as of date of order for relief.
  - b. A tentative financial statement prepared by an examiner, as of the date the debtor became insolvent, according to available records.
  - c. A recommendation regarding the need for the appointment of an independent examiner to conduct a more complete investigation of all activities of the debtor since the beginning of insolvency which led to order for relief.
7. The debtor-in-possession should be held personally responsible for any diminution of net assets available for unsecured creditors, to the extent that

such diminution exceeds limits authorized in advance by creditors' committee. If debtor is unable to pledge adequate security, or a bond, a trustee representing the interest of creditors should be appointed.

8. In a chapter 7 proceeding, pay of the trustee should be measured by total improvement in payments to unsecured creditors, as well as the time expended. The present provision of measuring pay by dollars handled is completely unrealistic and unfair. Once a reasonable method of paying the trustee is established, he should not be permitted to also appoint himself and collect fees as his own attorney or accountant. The existing practice is deceptive, and often dishonest.

9. Any indications of fraud or violations of U.S. law should be reported by the trustee, through the U.S. trustee, to the U.S. district attorney and to the FBI. Copies of the report should be sent to the Attorney General. A response should be required from the district attorney and the FBI within 30 days indicating what action is being taken, or a report giving reasons why there is need for further delay or a decision not to act.

Senator DeCONCINI. Our next witness will be Mr. Oliver Revell, Deputy Assistant Director, Federal Bureau of Investigation.

Thank you for being here today. Sorry to keep you waiting.

We can put your full statement in the record. You can highlight it or however you please.

**STATEMENT OF OLIVER REVELL, DEPUTY ASSISTANT DIRECTOR,  
FEDERAL BUREAU OF INVESTIGATION**

Mr. REVELL. My name is Oliver B. Revell, Deputy Assistant Director of the Federal Bureau of Investigation.

I have submitted to the committee a statement that was prepared by a combined effort of our Organized Crime and White Collar Crime Sections. I oversaw the final product.

What we have tried to do, Mr. Chairman, is give you a statement on our current position; vis-a-vis the National Bankruptcy Act, what changes we see as a result of the recent amendments of the act; our position on the use of the criminal statute, and the criminal aspects of the statute for investigative and prosecutive purposes.

I think you will note in the statement we highlight, that even though violations of the Bankruptcy Act in fact do occur, in most instances the prosecutors prefer to utilize other available Federal statutes; namely, fraud by wire, mail fraud, interstate transportation, stolen property, conspiracy, and, of course, the racketeer influence and corruption organization statute. If I was to say why that would generally occur, there seems to be a reluctance on the part of U.S. attorneys to utilize what they foresee as a fairly complex statute which is misunderstood by juries and perhaps even discouraged by judges. This is not to say bankruptcies themselves, particularly scam or bust-out operations, are not of vital concern to us. And where bankruptcy criminal procedures and the available penalties would be more appropriate, they are certainly utilized.

The statistical information set forth in the statement relates strictly to the use of the criminal provisions of the NBA statute itself. It does not take into account fraudulent bankruptcies utilizing all the other Federal criminal penalties or statutes. The 72,000 man-hours per year to investigate approximately 1,300 matters received under the criminal provisions show a substantial commitment. However, this is certainly not the total commitment of the FBI and the Justice Department in this area. We feel that the RICO statute, when we are

talking about organized crime, is the paramount statute because of its more severe penalties and the forfeiture provisions and the civil forfeiture aspects of that statute.

At the present time, of course, RICO is our principal weapon, and NBA fraud is a predicate act under the RICO statute. So we get into these scam operations, bustouts, particularly where organized criminal groups and cartels are involved through this particular statute.

I would be glad to answer any questions on the statement, sir. I don't know what else you might be interested in.

Senator DeCONCINI. How many active cases does the Bureau have now in bankruptcy fraud?

Mr. REVELL. Mr. Chairman, it would run approximately 1,300, as we set forth in the statement. The number of cases will vary by a small percentage each month.

Senator DeCONCINI. 1,300 active investigations in bankruptcy frauds?

Mr. REVELL. Yes, sir.

Senator DeCONCINI. How many of those do you believe to be related to organized crime?

Mr. REVELL. I would have no way of knowing at this point. Several of the major cases obviously do. We do not, under the NBA statute, track which ones have organized crime involvement and which ones do not, unless we are in the RICO statute area itself.

Senator DeCONCINI. How about your organized crime unit? Do their records indicate that they have organized crime investigations that involve bankruptcy scams?

Mr. REVELL. Again, sir, we don't break down statistical information on that basis. It would require a case-by-case search for that type of information. If the committee feels it is necessary, we can prepare such documentation. It will take extensive case-by-case research.

Senator DeCONCINI. My concern is we have had quite a bit of testimony, including some people in the witness protection program, that have been involved in bankruptcy in the Boston area, and other areas of the country, indicating that organized crime is deeply involved in that.

Would you concur with that?

Mr. REVELL. I certainly would.

Senator DeCONCINI. And in light of that, when you get involved in an organized-crime-connected bankruptcy, do you have any expertise that you use just in that area?

Mr. REVELL. Well, sir, we don't approach it from the NBA statute. We approach it from the target. And the target is organized criminal enterprise. We believe we do have expertise in this area.

The reason we don't break it down by statistics on NBA or any other statute is because we are interested in the criminal cartel itself, and whichever statute that can be utilized to interdict and prosecute their activities is what we are interested in. Certainly we do recognize and have recognized for some time the intrusion of organized crime into the bankruptcy fraud area. It is an area that we do receive training amongst our agents; our accounting agents are schooled in it; our organized crime agents are aware of it. We utilize the provisions of several statutes, including the Title III: Electronic Interception statute, in these type cases.

Generally, we do prefer to stick to an area where it is more easily understood by the juries, and that would be the straight fraud statutes, either wire or mail, or going into the NICO statute, because of its greater appeal to both the jury and to the judge and its greater penalties. This does not mean that we should be reluctant to use the statute, only that we find better tools available to us.

Senator DECONCINI. Mr. Revell, do you feel handicapped by some Federal laws like the Freedom of Information Act, the restraints that have been placed on the IRS; has this handicapped your investigations at all?

Mr. REVELL. The Tax Reform Act is a very definite deterrent to mutual cooperation between the FBI and IRS. In essence, we get extremely limited information from IRS, and cases that we should be working jointly, we have a very difficult time in doing. So very candidly; yes, sir, the Tax Reform Act is an impediment to effective enforcement when we are talking about high-echelon organized crime and high-echelon white-collar crime.

The Freedom of Information Act I don't believe at this point has any significant impact on this particular problem, with the exception of the development of high-level sources of information and informants. A general chilling effect brought about by the Freedom of Information Act is certainly present in our ability to develop high-echelon, highly placed informants within the inner circles of organized crime.

In that regard, yes, sir: I would say yes: it does have a negative impact. We are still attempting to measure the impact of the Financial Privacy Act. I can say that we have seen a great deal of confusion on the part of financial institutions. A failure to disseminate to the law enforcement agencies, including the FBI, criminal acts which come to their attention; even after they do make a referral, an extreme delay in receiving documentation as to the predicate offenses that we need to get into in an investigation.

We are closely reviewing this with the Department of Justice, and I think we will be documenting for the Judiciary Committee some of the problems we have with this particular statute.

My candid answer is, again, sir, it does have a negative impact on our ability to get into the high-level, organized and white-collar crime echelon.

Senator DECONCINI. You indicate you will have some specific recommendations or suggestions for the full Judiciary Committee. When will those be forthcoming?

Mr. REVELL. That is the prerogative of the Attorney General. I do not know. It is ongoing. We have had discussions.

Senator DECONCINI. Have those been submitted to the Attorney General?

Mr. REVELL. There have been certain preliminary examples, and statistics submitted. The FBI, as well as other agencies, are gathering such information. I can't speak for the Attorney General, but I believe he probably will be coming to the committee with some sort of—at least the update on the impact.

Senator DECONCINI. Has the Bureau submitted their final recommendations?

Mr. REVELL. Not final, some interim—I should not say recommendations—some interim information indicating we are gathering additional information. We have only had a short time under the statute.

Senator DECONCINI. When do you think that will be completed from the Bureau's point of view?

Mr. REVELL. A final report, I don't know, sir. But we will have, I think within 6 months, a sufficient track record to enable us to perhaps make recommendations to the Department. Certain provisions of the act only became effective this fiscal year, October 1.

Senator DECONCINI. What procedures does the Bureau have for following up after complaints where businessmen or associations have come to you, or Federal district attorney, or it has been referred to you in some manner? Do you have any followup procedures?

We have heard a number of witnesses that indicate that they would like to know that the investigation is ongoing. That once they turn over information they rarely see anything, and a year goes by and they don't know if the case has been dropped.

What procedures does the Bureau have?

Mr. REVELL. As far as notification of complainant, generally on the basis of complainant again asking, unless, of course the complainant is brought into court as a witness, we do not have a program of going back and informing the complainant of the result of the investigation.

Senator DECONCINI. Is there any reason not to do that? Has there been something in the Bureau to try to keep the victim advised at least on the periphery of how the case is going.

Mr. REVELL. The victim certainly can be advised upon inquiry, if he is not involved in the ongoing case through the grand jury and petit jury. The basic reason is, sir, the matter of time and resources. The problem being that many times we receive complaints, and thereafter the complainant is no longer in the same location and so forth, so we do not have a systematic program of advising complainants of the final disposition of the case. Of course, many times the case will continue for a very lengthy period of time, and it will be consolidated into other cases. You would have multiple complaints.

You have the problem of sorting out on a notification process. There is no prohibition against advising a complainant of the status of a case or if the U.S. attorney has declined to consider prosecution of the case and we have closed the case.

We will give that information upon request. We do not have a systematic manner of notification of complainants. Most of our complainants in these type cases, the bankruptcy court or U.S. attorney, which are, of course, aware of our investigation on a continuing basis; individual citizens would be the exception of which we are speaking.

Senator DECONCINI. We find some frustration by testimony with the business people that are involved as victims, who wonder what is happening; and are continuously feeling neglected. I welcome you returning some of its training or suggestions to its agents when they have an active case, that they let the victim know that it is still being pursued.

Mr. REVELL. We will review this with interest.

Senator DECONCINI. We had a witness this morning that made reference to what he referred to as Israeli Mafia in the California and Arizona area. Are you familiar with that organization?

Mr. REVELL. The Israeli Mafia? No, sir; I am not.

Senator DeCONCINI. The testimony indicates that it has been very prominent in what is known as bustouts, also in extortion and intimidation, operating in southern California. You have no reference to the Israeli Mafia?

Mr. REVELL. We have cases, sir, against criminal groups in these type of operations that you have just described. And perhaps there is an association. I do not have any information that we have developed that is a situation that you—

Senator DeCONCINI. The Bureau has nothing that is referred to as Israeli Mafia operating in southern California?

Mr. REVELL. No, sir.

Senator DeCONCINI. Indictments have come forward in Arizona that are supposedly tied to the Israeli Mafia—Erlich, Perez, and Seifert. Those are not known cases to you?

Mr. REVELL. I am not aware that they are referred to as Israeli Mafia cases. We have these type cases under investigation and indictment, and we do have certain confederations operating in Arizona and southern California, as we do throughout the country, that are systematically involved in the scam bankruptcy operations, as well as other types of organized criminal activity.

We simply have not—I have never heard of the characterization.

Senator DeCONCINI. We have a newspaper account which obviously is not always the most factual, I must admit, from the Valley News that makes some reference to the Israeli Mafia, and several homicides, and I am surprised to hear that you don't know anything about it.

What about the Drug Enforcement Administration and its dealings with the trade of arms and drugs with a group known as Israeli Mafia? You have no knowledge of joint efforts between your Bureau and the DEA?

Mr. REVELL. Senator, I think we probably have information about the groups that you are talking about. It is simply a matter as to how they are characterized.

I have, as I said, not heard the term utilized, Israeli Mafia. This does not mean we would not be aware of the cases you are referring to, the particular groups that may be referred to by newspaper reporters or journalists in this term.

The problem I think is one of definition. Of course, there are many types of organized crime groups. Many of them based upon either ethnic or racial backgrounds but not totally so. So I think we are talking here a matter of semantics more than anything else.

Yes, of course, we are aware of the types of cases and perhaps the specific cases of which you speak.

Senator DeCONCINI. I don't want to belabor the point. The Los Angeles Police Department refers to it quite openly as Israeli Mafia. I am advised your Los Angeles office uses that term and is very knowledgeable of what is going on. You seem to indicate to me that you aren't aware of it.

Mr. REVELL. I personally am not aware.

Senator DeCONCINI. I don't know that this article is absolutely accurate, but on October 16, 1979, from the Valley News, in the Los Angeles area, it says a spokesman for the FBI, Los Angeles office,

said the group's activities, meaning Israeli Mafia, have been the subject of a very extensive investigation that is still being conducted.

The Israeli Mafia investigators estimate that there are more than 100 members of the Southland, many of them living and working in San Fernando Valley, with as many as 1,000 public affiliates with the mob access across the country.

I would like to call that to your attention for whatever value it might be. It seems to me it is of significance, and importance, if the testimony we received this morning that they are deeply involved in the bankruptcy fraud, and if your Bureau can put together some information that would help this committee concerning that group or whatever you want to refer to it as and its involvement in bankruptcy fraud. It would be extremely helpful to us.

Mr. REVELL. All right.

Senator DeCONCINI. If it is a confidential nature, I understand that, and I am not asking any information that is involved in an ongoing investigation, and, of course, we can go into closed session, but we are trying to gather what the significance is of organized crime involved in the bankruptcy.

Mr. REVELL. Sir, around the country, you hear of things like Irish Mafia, and Mexican Mafia, and so forth. Street agents may refer to them in the same manner that police do. We do not do so. This does not mean that we do not investigate or understand the interconnections between ethnic groups in organized crime.

I am not trying to mislead you in the fact that there may not be a group operating that is called in popular parlance the Israeli Mafia.

What I am saying is we investigate groups in fact and have not characterized either officially or even unofficially, to my knowledge, such a group. I don't want to mislead you that we are not aware of and investigating individuals that have been publicly identified as being members of such a group.

Senator DeCONCINI. Can you provide us with any information on the activities of organized crime in the southern California area as it relates directly to bankruptcy fraud.

Mr. REVELL. We will certainly attempt to do that.

Senator DeCONCINI. I have no further questions. I thank you for your testimony.

Mr. REVELL. Thank you, sir.

[The prepared statement of Mr. Revell follows:]

PREPARED STATEMENT OF OLIVER B. REVELL

Senator DeConcini: Director Webster has asked me to convey his regrets in not being able to appear before you today. Understanding fully the importance of these hearings, he has asked me to be available to testify today concerning the Federal Bureau of Investigation's role in handling bankruptcy fraud cases.

The substantive law of bankruptcy and the bankruptcy system were originally designed in 1898. Prior to the revised National Bankruptcy Act, which became effective 16 days ago, the substantive laws and system had undergone their last substantial overhaul in 1938 and had been strained by the steady numerical growth of bankruptcies.

Under the provisions of the National Bankruptcy Act (the NBA), the FBI has been charged with the responsibility of conducting investigations relating to violations of the criminal provisions of the NBA.

Although the NBA names bankruptcy court officers as the persons on whom the duty of referring violations is imposed, many violations are referred to the FBI by different sources such as attorneys, creditors, business organizations, interested citizens, and confidential informants.

The FBI investigates the following criminal offenses under the NBA which are each punishable by 5 years imprisonment, \$5,000 fine, or both:

1. Concealing assets of a bankrupt estate.
2. Making a false oath in connection with a bankruptcy proceeding.
3. Presenting a false claim against a bankrupt estate or embezzling funds from a bankrupt estate.
4. Falsifying, destroying, or concealing books and records in connection with a bankruptcy proceeding.
5. Giving, offering, receiving, or attempting to obtain money or property in exchange for acting or forbearing to act in any bankruptcy proceeding.

The historically stated purpose of the NBA is to allow an honest debtor who is overwhelmed by his debts an opportunity to make a fresh start in life and to remain a useful member of society by relieving him of the oppressive burden of his debts.

In view of the intent of the statute, historically, neither prosecutors nor judges have appeared to favor vigorous prosecution for many violations of the NBA. Therefore, successful prosecutions are generally obtained only in cases with aggravated circumstances.

Experience has shown that violations of the NBA tend to fall into two broad categories. For the purpose of discussion, the categories are defined as follows:

The first of these categories is composed of incidents which originate with a legitimate bankruptcy. That is, the debtor is legitimately bankrupt and, at the inception of the bankruptcy proceeding, had no intention of committing a fraud. However, at some point in the proceeding, the debtor purposefully or inadvertently, through ignorance or carelessness, violates a provision of the NBA. Regardless of the intention the part of the debtor, losses sustained by the creditors, due to the fraudulent act by the debtor, are usually negligible. Debtors in this category are seldom repeat offenders.

The other main category is composed of so-called "scam" bankruptcies. "Scam" is a slang word used by hoodlums and white-collar criminals to describe a scheme of "planned bankruptcy" based on criminal intent to defraud creditors prior to the actual institution of bankruptcy proceedings. Losses to creditors in this category can be substantial. The schemes used to perpetrate the frauds are often elaborate and complex and may require months to complete. Offenders in this category are often expert "con men" and may repeat their schemes several times. Reported violations in this category have increased steadily since the mid 1960's.

The scheme generally consists of (1) overpurchasing of inventory on credit, (2) sale or other disposition of the merchandise thus obtained, (3) concealment of the proceeds, (4) nonpayment of creditors, and finally, (5) the filing of an involuntary bankruptcy petition by creditors.

Credit is the keystone of all "scam" bankruptcy schemes. The "con men" acquire controlling ownership in a business and soon thereafter begin buying tremendous quantities of merchandise on credit. As soon as the merchandise is delivered, it is immediately removed from the business. The "scam" operators generally rip off all identifying labels from the shipping cartons, destroy the bills of lading and invoices, and deliver the goods in rented trucks to prearranged outlets or to a covert warehouse for subsequent "disposal."

Many of the "disposal" outlets are "fences," organized crime controlled companies, and businesses which are anxious to purchase the merchandise with no questions asked at very low prices. In some instances the merchandise is sold to honest dealers who actually believe they are getting a tremendously unusual bargain. Merchandise is generally sold between 25 and 65 percent below the manufacturer's or supplier's retail price, but this is all profit to the "scam" operator since he never intends to pay for any of it. Since most merchandise is purchased on a 60 or 90-day credit basis, the "scam" operator has 2 or 3 months to dispose of the merchandise.

It has been found that many, but not all, "scam" operations occur in the "general merchandise" field involving items with a wide market appeal that can be bought and sold in volume without attracting too much attention. Usually, the goods are easily transported and difficult to trace. Some of the common items are electrical appliances, television and stereo sets, radios, furniture, cameras,

jewelry, clothing, furs, luggage, cigarettes, meat and poultry, frozen foods, and automobile accessories.

The proceeds of "scam" operations are easily concealed in that no systematic or orderly books and records are maintained concerning the acquisition and disposition of merchandise. Bills of lading, purchase orders, invoices, and other logical records normally maintained in a business are willfully and purposely destroyed. Generally, bank accounts are maintained; however, nominal deposits are made, and it is difficult to trace business transactions to these bank accounts.

When creditors call seeking payments, the "scam" operator explains that he cannot pay. He uses a variety of alibis such as burglary losses, destruction of inventory by fire, or large losses of assets due to gambling.

When creditors' formal complaints mount to a certain point, an involuntary bankruptcy petition is filed by the creditors.

Although the incidents of "scam" bankruptcies has shown a striking increase in recent years, this type of fraud is by no means a new innovation. It has appeared from time to time over the years, but until recently, it was almost the exclusive province of the lone entrepreneur. Now, however, a new feature has been added—organized crime. There are indications that the majority of "scam" bankruptcies are inspired and controlled by organized criminal groups. The Department of Justice has estimated that the average amount by which creditors are victimized, in a single "scam" operation, is in excess of a quarter of a million dollars.

The FBI recognizes that the abuse of bankruptcy laws is an expected result of the acquisition of legitimate businesses by members of organized crime. Usually the original acquisition of legitimate business comes about through usurious extensions of credit or outright extortion of the legitimate businessman. The hoodlum element has shown no interest in assuming the day-to-day responsibilities of running such a business, especially when they can simply undergo bankruptcy and remove himself from those responsibilities after realizing a substantial profit. Since he holds title to very little real or personal property in his own name, and he is usually not dependent on legitimate credit sources, he has, in effect, lost nothing.

The organized criminals' widespread misuse of the bankruptcy process to effectively gut the capital of legitimate businesses was explicitly recognized by Congress when they made any violation involving bankruptcy fraud a predicate offense of title IX of the Organized Crime Control Act of 1970. This law is now popularly known as the Racketeer Influenced and Corrupt Organizations (RICO) Statute. Today, it is our most effective tool in combating organized crime's growing involvement in bankruptcy fraud. The RICO Statute specifically outlaws both the acquisition and the use of any enterprise to commit a pattern of criminal activity. As you know, the Statute has severe sentencing powers as well as unique civil remedies, including forfeiture, recovery, and injunctive procedures, which the Federal Government can implement against these violators.

To date, every field office of the FBI has received mandated training in the application of the RICO Statute. Our inservice training programs also include specific training in financial flow and bankruptcy fraud investigations as they are applied to targeted members of organized crime. Information received from the field indicates that members of organized crime have also become well aware in the forfeiture provisions of the RICO Statute, and, in certain circumstances, are as fearful of these provisions as they are of the incarceration penalties.

During the past 3 years, the FBI has expended approximately 72,000 manhours per year to investigate an average of 1,300 matters received under the criminal provisions of the NBA. This effort has resulted in 110 convictions, \$195,410 in fines, and recoveries of illegally obtained funds in the amount of \$1,438,174. These figures represent investigations of bankruptcy frauds conducted only under the provisions of the NBA and, therefore, reflect only a relatively small part of the FBI's total investigative effort. Most bankruptcy frauds involve other Federal crimes in addition to those enumerated within the criminal provisions of the NBA. Other than violations of the RICO Statute mentioned earlier, many bankruptcy frauds also involve such crimes as fraud by wire and/or mail fraud. In such cases, violations of other simultaneously committed Federal violations are often prosecuted in favor of violations of the NBA because they are less difficult to prove to a jury. Although specific statistics as related to bankruptcy fraud investigations are not retrievable from our normally com-

piled statistics concerning RICO, fraud by wire and/or mail fraud investigations, the FBI's accomplishments in these areas are dramatic and continually increasing.

The following are examples of recent FBI investigations concerning the role of organized crime in the bankruptcy process.

Over a 3-year period, two well-known members of a Northeastern organized crime "family" instigated a scheme involving the extortion of the manager of a local finance company. The manager was forced to authorize approximately \$900,000 worth of loans to individuals purchasing furniture from the "family" businesses. The finance company suffered a loss of approximately \$450,000. In addition, one of the stores was destroyed by arson and investigation proved that most of the furniture had been removed from the burned store before the fire. As a result of this alleged loss of merchandise, \$276,000 worth of insurance claims were filed and the subjects also filed for bankruptcy. Subsequent investigation by the FBI resulted in the convictions of both subjects.

Another specific example of the abuse of the bankruptcy process can be found in a recent investigation wherein organized crime members bought an interest in a legitimate beauty supply company, established a significant line of credit, purchased a large amount of merchandise on credit, and sold the merchandise for cash. Large amounts of cash accumulated in their bank accounts and, thereafter, checks were drawn on the accounts to establish further lines of credit in gambling casinos in Las Vegas and the Bahamas. The conspirators then proceeded to the gambling casinos and purchased chips with the line of credit, and, thereafter, redeemed most of the chips for cash. Again, when creditors threatened legal action regarding nonpayment of large bills for merchandise, the conspirators declared bankruptcy.

Recently, in the Midwest, two individuals devised a scheme to take over and "strip" the assets of 11 retail stores throughout the United States. Their methodology was to incorporate various "shell" companies and then represent that their parent company was part of a large conglomerate with sizable assets and investors. Upon takeover, all bank accounts of the 11 victim companies were consolidated and the funds were transferred to accounts controlled by the two subjects. Merchandise was put on sale at far below wholesale value and the proceeds from these sales were transferred to the "shell" companies. Delay letters were sent to creditors falsely advising that the companies purchased were in poor financial condition and a third nonaffiliated company was going to purchase the debt of the victim companies. After the creditors were compromised, the third company, which was actually another "shell," then filed involuntary bankruptcy documents against the victim companies, thus becoming a prime secured creditor. Since they were the prime secured creditors, the subjects had first claim in any remaining funds of the victim companies. During the course of this investigation, over 80 bank accounts were discovered and funds from these accounts were traced directly to the subjects. One of the subjects entered guilty pleas to violations of the RICO Statute and received sentences totaling 8 years. The other subject died of a heart attack before trial.

Senator DeCONCINI. Our next witnesses will be Jack Slimovitz, attorney for trustee, Badger State Cheese Co., bankruptcy case; George M. St. Peter, attorney for Associated Milk Producers, Inc., Fond du Lac, Wis.

Please proceed with any opening statements you have. We have some questions, and I am interested in the involvement of the bankruptcy aspects of the cases that you have been very familiar with; and also thank you for taking the time to be here today to help us get a better understanding of the severity of this particular problem as it affects legitimate business.

**STATEMENTS OF JACK SLIMOVITZ, ATTORNEY FOR TRUSTEE, BADGER STATE CHEESE CO. BANKRUPTCY CASE, AND GEORGE M. ST. PETER, ATTORNEY FOR ASSOCIATED MILK PRODUCERS, INC., FOND DU LAC, WIS.**

Mr. St. Peter. I will start. I am George St. Peter, attorney at Fond du Lac, Wis.

I am an attorney for Associated Milk Producers, Inc., whose members sell milk to a couple hundred plants in Wisconsin.

I was involved in the Badger State Cheese Co. case for AMPI, and we had 125 farmers shipping to that plant.

The farmers typically sell milk, for example, from the first of June to the first of July, and get paid by the 15th or 20th of the following month. Therefore, at Badger State, a typical small cheese factory in northeast Wisconsin, east of Green Bay, Wis., those farmers shipped milk in 1976 from the 1st of June through about the 15th of July. They are not paid during that period.

About the last part of July the owner of the plant called the State of Wisconsin and said, "I cannot pay the farmers." I got notice the next day, since AMPI is the largest supplier of milk, met with the owner, and said, "Why can you not pay the farmers?"

He said, "We have sold our cheese to our customer in New York, and he has not paid us. Usually, we pay within the period."

"Who is your customer?"

"It is the Capital Cheese Co."

"Well, who are they?"

"They own our company."

I said, "How can they own you?"

[We have a credit bureau and staff, and Associated Milk Producers in the State of Wisconsin, and I have all the recordings, and I've never heard of Capital Cheese Co.]

"Well, our owners now are the Gambino and Falcone family of Brooklyn, N.Y."

"Who are they?"

"Well, they are cheese buyers."

I checked around and found that everything in the Badger State was mortgaged to the bank in Green Bay, or State of Wisconsin, as far as cheese is concerned. I found that the little bank of Luxembourg advanced payroll for the preceding 15 days, \$208,000, and then I discovered the same day through the Milwaukee Journal—I want to acknowledge publicly the accuracy of the August 1 article of the Milwaukee Journal, which you have, I think—I gave it to Mr. Fiedler—which sets forth complete relationship of the Gambinos and Falcones. And at that time Carlos Gambino was not involved. He was the top member of the Mafia in the United States, as I understand it.

These were his relatives who had been involved in a similar situation in Vermont.

Well, in checking back, I found that without notice to us as farmers who extended credit, or to the State of Wisconsin, these Falcones and Gambinos had come in and purchased 70 percent of the stock of this Badger State, which was in financial trouble. They took over the op-

eration of the plant, and brought the cheese from this plant to Brooklyn, N.Y.

I checked the Capital Cheese Co., and they just barely got it incorporated in time to get the thing in operation. They took over the company, Badger, in December—December 15 at the board meeting—and did not form Capital Cheese until the middle of March.

So here we are on the day that I walked into the thing and said, "You cannot have any more milk." I said, "You do not have any equipment." Where did the equipment go? Well, the Falcones took the equipment with them. So here we have a Wisconsin cheese factory, meeting their friends from New York and ending up with nothing, not even cheese equipment.

So the question: What do I do? I do not usually turn to bankruptcy over the last 30 years in representing farmers, because we usually try to have security, through the State of Wisconsin.

In this State, knowing the State had security, knowing banks had security and another bank had advanced money, I became quite frightened about loss of money. So I went to the bankruptcy judge in Milwaukee, Judge Dale Ihlenfeldt, the next day, and by then the author of the Milwaukee Journal had published his article, and I'm willing to rely on that—have not been sued for libel yet on that one—and alleged specific involvement of the "Mafia."

I got Ihlenfeldt, who heard me, and I petitioned for bankruptcy, appointment of trustee, receiver. Jack just came into it, and he is an experienced bankruptcy man, best in the State—and I did that because I did not know where we would be under the RICO statute. RICO is in our interest.

Here is a group of hoodlums, whoever they were, having done the same thing in Vermont and Indiana, and did it to us. We have \$80 million a month of open milk accounts in Wisconsin, and to have somebody walk in without knowing it, take over our plant, take our cheese, is very serious.

It was RICO I was interested in, and I of course notified the FBI and the U.S. Attorney. Now what has happened is, we have been paid, we farmers, under our accounts receivable with the State, have received 100 cents on the dollar, and our AMPI farmers get paid the same day.

The other 275, with about \$300,000 money, did not get paid for a year and a half. These farmers, in northeast Wisconsin, did not get paid for a year and a half.

So I merely bring forth to you the names—I presume I do not have to go into any more detail with names; I can file that with your committee—the Milwaukee Journal account gives them. This, of course, is the Bonanno territory, you understand, sir.

You people in the Southwest have inherited a piece of Bonanno now, but he comes from Fond du Lac, and he started in Fond du Lac. These are some of the ramifications we have around there. Not much, so to that extent I come here merely to tell you that this group of people whose names I have given you—the Falcones, the Gambinos—bought into this company, raided it, took the cheese, didn't pay the farmers, and had \$1 million for the cheese, and claimed it was poor cheese.

They finally paid up the farmers. We got our half a million dollars out of it. And the unsecured creditors—I assume Mr. Slimovitz will tell you about—I do not think they have achieved anything. I dropped out after that, because our farmers got the money. With that introductory background, I have Mr. Jack Slimovitz continue.

Mr. SLIMOVITZ. I am Jack Slimovitz, attorney from Milwaukee. I have been in the bankruptcy field for about 20 years actively, as trustee and attorney for the trustee. And about 70 percent of my business background—of my practice—is connected with bankruptcy.

Just to give you some dates on this thing that Mr. St. Peter referred to: I may be a little repetitious, but I think it is necessary.

The Badger State Cheese gave a security agreement to the State of Wisconsin Department of Agriculture, and financing statement, in July 1970, so they obviously were in some sort of financial trouble at that point.

Mr. ST. PETER. No; under the dairy plant security law you have to get a license, good financial statement, or we take a security agreement; it was under that, Jack.

Mr. SLIMOVITZ. That statute, 100.06, Wisconsin statute.

Anyhow, there was the security agreement, financing statement was given. And the financing statement was then filed with the secretary of state, State of Wisconsin.

On December 9, 1975, the stockholders, the Koss family, sold 70 percent interest in this company to Thomas Gambino, Rosalynn Gambino, Joseph Gambino, Richard Falcone, Mary Diaz, and Matteo Falconi—sold them 2,333 shares at \$10 a share. They also sold them Italian cheese-making equipment for \$60,000, and loaned the corporation \$176,000.

Senator DECONCINI. Did this all occur at one time?

Mr. SLIMOVITZ. Yes, sir. This is in the agreement of December 5.

Senator DECONCINI. What amount of the company did this account for?

Mr. SLIMOVITZ. Seventy percent. They bought some treasury stock. There were a thousand shares outstanding. It really is not clear, the transaction, but they must have bought about 70 percent of that, and there were 1,333 additional shares.

They provided, in the agreement, that the sale of the 1,300 shares, the cash for the sale of 1,300 shares, and \$176,000, was to go for the milk patrons.

The corporation, which had been making cheddar cheese, with a 10-percent water content—and please understand that I am not an expert in cheese, although dealing in this field, maybe I have become sort of a pseudoexpert—the cheddar cheese they had been making had 10 percent water content and mozzarella and soft feta cheese is what they were going to make from that point on. It had 15-percent water content, so there was a little more margin of profit. These cheeses were made, and they shipped this inventory of cheese to New York, the Capital Cheese Co., which is incorporated, on March 3.

We estimate that the Capital Cheese Co. at that time owed the Badger Cheese about \$600,000. Now, Mr. St. Peter has referred to the involuntary petition in bankruptcy filed on August 6. I was appointed receiver in the involuntary, which is a valuable tool. I think

it has been alluded to by some of the other witnesses. I think it is an extremely important tool for the judge to be able to appoint a receiver in involuntary bankruptcy now under section 303. He can appoint an interim trustee to request a party in interest, and I think that is an extremely valuable tool.

Senator DeCONCINI. Now the purchasers of Badger Cheese Co. were individuals under the agreement?

Mr. SLIMOVITZ. Yes, sir.

Senator DeCONCINI. The Capital Cheese Co. did not purchase any of that?

Mr. SLIMOVITZ. Capital Cheese Co. was just a customer.

Senator DeCONCINI. Just a customer.

Mr. St. PETER. The people he named issued their individual checks to purchase the stock of the company.

Senator DeCONCINI. What do you know about the Capital Cheese Co.?

Mr. SLIMOVITZ. All we know is that it was incorporated in New York State, March 3, 1976. It continued in operation for a period of time, and I do not know the exact date, but sometime in 1977 made an assignment for the benefit of creditors in New York State.

Senator DeCONCINI. Do you know any of the principals in the company?

Mr. SLIMOVITZ. I do not know that.

Senator DeCONCINI. In the Badger Cheese Co., is Mr. Bonanno a purchaser to your knowledge?

Mr. St. PETER. No, sir. He is not involved in this at all. I mention him only to give you local picture.

Senator DeCONCINI. To your knowledge, is he still an investor in that Fond du Lac area?

Mr. St. PETER. I have no knowledge of that, sir.

Senator DeCONCINI. Go ahead, Mr. Slimovitz.

Mr. SLIMOVITZ. The schedules in bankruptcy indicated there were \$13,000 due as wages; \$17,000 due as taxes; and for some reason, the schedules only indicate that there is \$176,000 due to milk patrons.

It is a little confusing because of the lien that the State of Wisconsin had, but the State of Wisconsin's lien was later established at \$505,000.

Senator DeCONCINI. Are you reading from the schedule that was filed?

Mr. SLIMOVITZ. Yes—not the schedule—my digest, my notes on the schedule.

The assets were approximately—were written about \$2 million. The plant was subject to a mortgage, real estate mortgage, and the equipment was subject to a security interest and financing statement, both in favor of the West Bank & Trust Co. in Green Bay.

Now what has happened is, as the Koss family needed capital, they pledged some of the cheese. This cheese was subject to lien of the State of Wisconsin, so it had been doubly financed. But as soon as the farmers would be paid, then the lien of the State of Wisconsin would drop out and the lien of the banks, second-position liens, would assume the first position.

Legal action was commenced by the West Bank & Trust Co. relative to this cheese, and there was a question whether some of that cheese

even existed. This did not have anything to do with the mozzarella and soft feta, and had nothing to do with the Capital Cheese problem.

The State of Wisconsin, Department of Agriculture—we figure that as long as—well, let me back up a little bit.

I was appointed receiver for the Badger Cheese on August 6. Then on August 16—

Senator DeCONCINI. Was that voluntary?

Mr. SLIMOVITZ. That was an involuntary proceeding started by Mr. St. Peter.

Senator DeCONCINI. On behalf of the farmers?

Mr. SLIMOVITZ. That is correct.

Senator DeCONCINI. Thank you. Please go ahead.

Mr. SLIMOVITZ. On August 16, 10 days later, they signed consent to adjudication, and Theodore Miller of Green Bay was appointed the trustee. My firm became the attorneys for the trustee. So I put a different hat on. This legal action was started by West Bank & Trust Co. in the circuit court of Brown County. They were looking to marshal their security. I stepped in and sort of directed the operations there, and we sort of felt that inasmuch as the State department of agriculture had its lien, and had established its collection procedure, it should continue.

All the contact with the Capital Cheese people was made through the department of agriculture. I have never made any contact with them.

They eventually received \$400,000 from Capital Cheese, \$400,000 of the \$600,000. This \$400,000, plus the collection of some other receivables not connected with Capital Cheese, enabled the department to pay off all the farmers.

Then sometime in 1977, Capital Cheese allegedly received a return of 100,000 pounds of mozzarella, and 30,000 pounds of soft feta. They said, we have this cheese, it has been returned to us for one reason or another. We want to claim this as a credit.

Capital Cheese in 1977, as I said, made assignment for the benefit of creditors in New York City. The receiver is presently collecting the assets, and he has informed me just the other day he has one remaining item to collect, and he expects to close his receivership in about 6 months.

This person, this company he is collecting from is paying on an installment basis, and the last payment will be done in about 6 months.

The total claims in the New York receivership case of Capital Cheese—and I think there are probably no more than six claims on file with the receiver—is \$203,000, and the Department of Agriculture has a claim for \$186,000.

Senator DeCONCINI. Do you anticipate they will be able to collect that?

Mr. SLIMOVITZ. I anticipate that we will probably get something like \$60,000 or \$70,000. The Department of Agriculture would realize something like \$60,000 or \$70,000 on its claim.

We then executed a stipulation dismissing the Brown County lawsuit. I was able to prevail upon all of the attorneys, and their clients, to let \$10,000 from the New York receivership come into the bankruptcy estate.

This money, plus the few other dollars we have, will come to about \$25,000, and after the payment of administration expenses, will go toward paying the wages. It is my anticipation that we will not be able to pay the wages in full. Under the Bankruptcy Act, wages had first priority. We will not even get into taxes in this situation. That is the way it stands at this moment.

Senator DECONCINI. What do you foresee for Badger Cheese Co.?

Mr. SLIMOVITZ. Well, the company bank purchased real estate and sold it to someone who liquidated it, and Badger State Cheese Co. is now completely out of operation.

Senator DECONCINI. It no longer is processing at all?

Mr. SLIMOVITZ. No; it is not.

Senator DECONCINI. What do your clients do now?

Mr. ST. PETER. We put our farmers in other plants. We have now been paid all the money due the farmers. The unsecured creditors are going to get practically nothing out of this.

Mr. SLIMOVITZ. We will get nothing. The only people who will get the money will be wage claimants.

Senator DECONCINI. What does that amount to, unsecured creditors?

Mr. SLIMOVITZ. I neglected to put that into this, but I would think there is probably \$1 million in unsecured credit.

Mr. ST. PETER. We have been, just to summarize if I may, this situation: We have a milk plant, we shipped milk to it, and we have credit reports, and we think we know what is going on. And without knowing it, they changed the stock ownership—did not report it to the secretary of State. We have no sign of any change. They are just people making cheese, and there is a lot of cheese in Wisconsin.

We did not learn about that until the check does not come from New York on the 24th of the month of July, when Mr. Koss calls and says, "I did not get my check. Better call St. Peter." He called me, and on the 25th I said, "No more milk goes in there." That is the end of the road right there, with somebody in New York with a half a million dollars of cheese.

Those people are Joseph Gambino, the son Thomas Gambino, two brothers Joseph and Vincent, and Jimmy Falcone of New York, and Joseph Gambino's brother, Carlos Gambino, boss of the bosses of New York, of the five Mafia families, and Joseph was the Mafia lieutenant.

These are the people that paid for the company, have been linked to many major crime figures and business ventures, according to the Milwaukee Journal on August 1. And I cite that, we in Wisconsin, sir, rely on the Milwaukee Journal as the record and the conscience of the reporting back to the State. I am quoting this knowing it is accurate.

These Gambinos have done the same thing in several other places, you see. I asked, where did the RICO violation go to?

Senator DECONCINI. Where else do you know that they have been involved?

Mr. ST. PETER. The article points out they were involved in Vermont and in Indiana.

Senator DECONCINI. To your knowledge, in the same kind of scheme?

Mr. ST. PETER. Exactly the same scheme, sir.

Senator DECONCINI. Unsecured creditors that are apt to lose upward of \$1 million. Can you give me some idea of who they are? Are they small service suppliers?

Mr. SLIMOVITZ. Yes.

Senator DECONCINI. Generally people in the Fond du Lac area?

Mr. SLIMOVITZ. Green Bay, Door County area. I might say one thing I neglected to say. At depositions in the New York State lawsuit, we asked Mr. Koss: "How did you make contact with the Gambinos?" And he said, as I understand it, that he advertised for credit, advertised for capital, in Cheesemakers Weekly, or some weekly publication that goes to all cheesemakers. I think that was his testimony.

Mr. ST. PETER. I hate to keep you from lunch, but I have one footnote here. My people in Wisconsin will read this. Jack is from Milwaukee, a city lawyer, and it is not 10-percent water, 12-percent water. Out of 100 pounds of milk, generally you make 10 pounds of cheddar cheese with the other byproducts, and 80 pounds of whey is recovered. We do not talk water, Senator—

Mr. SLIMOVITZ. I stand corrected.

Senator DECONCINI. How big a cheese company would you classify Badger Cheese in? Is it a very small company?

Mr. ST. PETER. Badger Cheese was moderately sized, an independently owned plant with about 350 farmers. A good-sized plant, about average in Wisconsin.

Senator DECONCINI. How many would you say are in Wisconsin?

Mr. ST. PETER. We sell to 210 cheese factories, so there must be more than that, plus some very large ones. Wisconsin is the Wall Street of the milk-manufacturing area. All the big ones are there. A lot of the cheese is made by people just like Koss with about 250 to 300 farmers.

Senator DECONCINI. Of course, thanks to you, Mr. St. Peter, and your astuteness in representing their clients, they are going to be all right, I guess. Maybe a little bit of a scare.

What do you think could be done by way of corrective measures to prevent activities such as the Badger State bustout?

Mr. ST. PETER. Senator, if I may point out, there are 47 States in the United States that do not have the dairy plant security law we have, where we require that. I feel sorry for the dairy farmers in the other States, New York, Pennsylvania, and Arizona, where they do not have any. When the plant goes broke, they have no security on hand; very little.

The only suggestion I have to make, that I felt very strongly on this case, I know about RICO. It looks like a good statute. I have read you the genesis, or whatever you call it, the background of the people involved; and certainly this would appear to be a classic RICO case.

To this date, nothing has been reported to me. If anything has been done beyond that, I do not know. If the FBI or the Department of Justice has any information, I do not know. I listened with great interest this morning to the deputy from the FBI and his report, showing hypothetical cases, mentioned nothing of these milk frauds.

Mr. SLIMOVITZ. I have talked to the attorney for the receiver in New York, and he has been—the FBI has been in contact with him, and at one time, did subpoena his records for a grand jury. But more than that, I do not know. I have never had any contact with the FBI.

Senator DeCONCINI. Are you familiar with the Grande Cheese Co.

Mr. St. PETER. Repeat that?

Senator DeCONCINI. Grande.

Mr. St. PETER. Am I familiar with Grande Cheese Co.? Yes, sir, for 30 years.

Senator DeCONCINI. Do you know who the principals are?

Mr. St. PETER. Yes, sir.

Senator DeCONCINI. Can you name them?

Mr. St. PETER. Without knowing the first names, the people of record are Candella. I will say, John Candella and his father with someone else.

Senator DeCONCINI. You do not know that Mr. Bonanno has any interest in that company?

Mr. St. PETER. Grande Cheese Co. is a case by itself. I must be cautious, because it is a solvent company paying its farmers, very successful. Grande Cheese Co. has had a checkered career, and did involve Mr. Bonanno initially, and it involved other people before that, and it is now just Candella.

Whether any other people are in it, I do not know.

Senator DeCONCINI. Thank you very much.

Mr. Slimovitz, what about unsecured creditors? What suggestions, if any, do you have that we might consider to provide some protection for those innocent victims of this organized crime activity?

Mr. SLIMOVITZ. Unfortunately, there is not much you can do. They have to be—perhaps it comes into, they should be more watchdogs of their own credit, and keep a closer eye on things.

They would have no way of knowing of the transfer of this company, I am afraid. There is not much we can do. We try to protect them and we do, as attorneys for the trustee and the trustees, investigate all of these matters quite thoroughly—involving fraud. Whether we are going to make a fee on the case or whether we are not going to make a fee on the case, we feel that investigation and bankruptcy is paramount. And we feel that if we are going to do a job, we want to do the very best we can possibly in the bankruptcy field.

Senator DeCONCINI. Do you think that the fee structure has any bearing on the willingness of trustees to pursue frauds?

Mr. SLIMOVITZ. I heard the prior witness testify that the fee structure gave him some trouble. I think that, yes, it does, to some extent, if you find there is not enough money to compensate a trustee, you cannot go very far; but there are ways of operating.

If you have a bankrupt estate where there is no money and it looks like there is some fraud or something that should be investigated, you make application to the court for instructions. You condense the creditors, everybody should throw in  $x$  dollars—larger creditors. And they put that in, they establish a fund.

Now you have the money to hire an attorney and make this investigation, and you provide that if you recover, they will get paid back their advances first. This is a beautiful vehicle, and we have used it a number of times.

Senator DeCONCINI. Successfully?

Mr. SLIMOVITZ. Yes.

Senator DeCONCINI. Do you see any merit in increasing those fees based on the recovery that might be made by pursuing a fraud? Would that encourage the trustee to be a little more aggressive?

Mr. SLIMOVITZ. I do not know. You run into the problem when you present an application to the bankruptcy judge for fees, and you say, "What kind of money did you produce?"

"Well, I produced—"

Senator DeCONCINI. "I did not get any, but I tried hard." Is that it?

Mr. SLIMOVITZ. Let's say you produced \$10,000, but you say he only spent 5 hours doing that. "Yes, Judge, but because of my knowledge and expertise in this field—"

Senator DeCONCINI. That is a good point.

Mr. SLIMOVITZ. There is not much you can do to compensate trustees, other than on money.

Senator DeCONCINI. Did you bring in the Federal Bureau of Investigation on this case?

Mr. St. PETER. In my case, I reported to the Federal Bureau of Investigation and the U.S. district—

Senator DeCONCINI. When did you do that?

Mr. St. PETER. Right after this thing started.

Senator DeCONCINI. What kind of response did you get?

Mr. St. PETER. I have heard nothing.

Senator DeCONCINI. Nothing back at all?

Mr. St. PETER. No. Since I am on record here, I want to publicly praise the State of Wisconsin for the care and completeness of the recovery under their security, which helped us.

I certainly want to thank Judge Ihlenfeldt, because we did run a bluff here, Senator, on these fellows. We have Slimovitz, who is a competent man, and we have Judge Dale Ihlenfeldt, who I consider one of the best judges I have ever seen, a good circuit judge in Green Bay, and we had the enraged dairy farmers of Wisconsin. No question this was a cause celebre in Wisconsin. These people were not going to sit around and let a few farmers get taken down the road.

I want to compliment Jack for his cooperation.

Senator DeCONCINI. I agree; those compliments are indeed deserved. You cannot help but have a great deal of empathy for the unsecured creditors who are really on the hook.

Thanks to your State law and your expert representation, the farmers were saved from huge losses, but it really disturbs us here to hear that kind of testimony that an organized crime family as far away as New York is able to milk \$1 million out of a small business and individuals in Wisconsin.

Mr. SLIMOVITZ. Our investigation at the beginning of this case, we felt there was probably very little for unsecured creditors. We felt there was very little equity in any of the assets. And a lot of the money came in from cashing in life insurance policies on the lives on the officers.

Senator DeCONCINI. Thank you very much, gentlemen. We appreciate your being with us.

The committee will stand in recess.

[Whereupon, at 1 p.m., the committee recessed, subject to the call of the Chair.]

## BANKRUPTCY FRAUD OVERSIGHT

FRIDAY, FEBRUARY 1, 1980

U.S. SENATE, SUBCOMMITTEE ON IMPROVEMENTS  
IN JUDICIAL MACHINERY,  
COMMITTEE ON THE JUDICIARY,  
*Phoenix, Ariz.*

The subcommittee met, pursuant to notice, at 9:30 a.m., in the Board of Supervisors Building, Phoenix, Ariz., Senator Dennis DeConcini (chairman of the subcommittee) presiding.

Also present: Romano Romani, staff director; Bob Feidler, chief counsel; and Bill Christensen, investigator.

### OPENING STATEMENT OF SENATOR DeCONCINI

Senator DeConcini. The Subcommittee on Improvements in Judicial Machinery will come to order. Good morning, ladies and gentlemen. We are here this morning to examine, in some detail, the problems of bankruptcy, fraud, and organized crime. The Subcommittee on Improvements in Judicial Machinery has jurisdiction over the Nation's bankruptcy laws. And, indeed, during the 95th Congress this subcommittee, working with its sister subcommittee in the House of Representatives, totally revised the Bankruptcy Code. This is an achievement of which we are all justly proud. The bankruptcy laws had become obsolescent and were no longer adequate to serve the needs of the modern economy.

During the many days of hearings and countless discussions associated with that work, the subcommittee began to accumulate a body of evidence suggesting that traditional organized crime syndicates were using bankruptcy law and bankruptcy courts to rob the American public of hundreds of millions of dollars annually. So serious did we consider this problem that we would have preferred to lay the Bankruptcy Code aside, until we had developed a strategy to deal with the abuse.

The subcommittee was ultimately persuaded, however, that a new Bankruptcy Code was absolutely imperative. Thus, at the time of Senate passage I made a commitment that an investigation into the abuse of bankruptcy by organized crime would be the subcommittee's No. 1 priority during the 96th Congress. These hearings represent the partial implementation of that commitment. We have already had 2 days of hearings in Washington, we are now moving into other parts of the country to obtain as accurate a picture as possible of the nature, methods, and extent of bankruptcy fraud and organized crime.

I should like to make it clear at this point that while the subcommittee is concerned about all forms of bankruptcy fraud, we are lim-

iting these hearings to these abuses associated both with traditional and nontraditional organized crime. Organized crime is a hydra-headed monster, it is quick to exploit loopholes in the law and weaknesses in the law enforcement system.

I believe that the United States has become complacent about the existence and growth of organized crime. I believe that we have deluded ourselves about its capacity to eat away and ultimately erode the foundation of our society. Unfortunately, movies and books like "The Godfather" have tended to paint a rather benign picture of the Mafia, Cosa Nostra, gangsters, but this picture is nothing more than the romantic doodling of a motion picture industry, which itself is involved in organized crime. Make no mistake about it; the Mafia-type gangster is a vicious and brutal outlaw. Still today the so-called "made member" of the Mafia must participate in the murder of another human being. These organizations are held together by violence, extortion and fear; they are neither romantic nor benign.

Unless we begin to move rapidly and effectively against this menace, we may well lose the capacity to act at all. To beat organized crime we need commitments by the Government and cooperation by all communities. But consider these facts: Mafia profits from the narcotic traffic alone is reliably estimated at between \$40 and \$60 billion annually; all tax free, I might add. If we include profits from pornography and gambling the total is easily in excess of \$100 billion annually. Much of this enormous illicit gain is invested into legitimate business enterprises. Organized crime is bullish on America, and it is becoming a major stockholder in our Nation's future. As the tentacles of organized crime reach deeper into the legitimate business community it will become even more difficult to differentiate organized crime from the rest of the community; furthermore, it will become ever more difficult to gain the cooperation of the community to fight organized crime.

As a Nation we must face reality. The time has come, hopefully not passed, to commit the manpower and resources necessary to do the job. We continue to be passive about organized crime. We are essentially saying that we will allow drugs and pornography to degrade our youth and defile our national future. For those of you who represent the law enforcement community, I want to continue to emphasize a law enforcement commitment. Let me emphasize that our inability to effectively deal with organized crime is no way a reflection upon the capacity, commitment, and sacrifice of hundreds of fine men and women; rather, the fault lies with us, politicians and the public, who have not given you the support you need. The fight against organized crime must, once again, be placed high on our list of National, State and local priorities.

Our witnesses today are exceptionally well qualified to provide this subcommittee with a thorough understanding of the problems of organized crime in Arizona and their involvement in bankruptcy fraud. We will hear from law enforcement personnel and prosecutors from all levels of government. We will also hear from members of the bar and citizens who have been victimized by bankruptcy frauds. We will begin the hearings with a panel composed of Mr. Gene Ehmann

of the Quad State project; Mr. William Shaefer, who is assistant attorney general for criminal matters; and Mr. Jack Smythe, who is in charge of the FBI Organized Crime Division in Arizona. These gentlemen will provide us with comprehensive, historical overview of the growth and evolution of organized crime in Arizona.

I would like to introduce the staff director of the subcommittee, Mr. Romano Romani to my left; Mr. Feidler, general counsel of the subcommittee; and Bill Christensen, member of the subcommittee's investigative staff.

Gentlemen, thank you for being here this morning.

Mr. Ehmann, if you would please proceed.

**STATEMENT OF GENE EHMANN, ASSISTANT DEPUTY DIRECTOR,  
ARIZONA DRUG CONTROL DISTRICT**

Mr. EHMANN. Senator, thank you very much for making me a part of your inquiry into the organized crime and bankruptcy fraud, particularly as it relates to Arizona. In my capacity, which is that of being in charge for the Arizona Drug Control District of our multi-state projects and of our organized-crime component which houses itself in our facility in Tucson, we have developed a number of ideas regarding organized crime as it relates to Arizona. And, if I may, I would like to share with you some of our thoughts in that area. Our contact, because of the nature of our multistate projects, which at this time includes the five States of Arizona, Colorado, Utah, New Mexico, and recently joining us, Nevada, and with some of the Federal agencies with whom we deal, has led us to view organized crime, as you mentioned in your introductory statements, not just as traditional Mafia intrusion into our lives but of virtually any organization which seems to self-perpetuate itself towards economic gains illegally. That certainly has penetrated into our State.

We try to view this problem of organized crime as a whole, as something that deals with a problem not only within Arizona but outside of Arizona, because we feel that the influence in Arizona is caused not only by those individuals involved in crime within the State but also by the influences from the east coast and from other areas where organized crime has been firmly entrenched for a number of years. I believe that the state of affairs in Arizona now is at a very critical stage. Where the east coast has been more obviously involved in criminal activities through the objective in issue, which we've seen over the years, we are, perhaps, where they were 20 or 25 years ago here in our State.

We've grown more slowly into the process, and by virtue of the difference in the problem here in Arizona, I believe it's a much more insidious problem.

I prepared a number of graphics which, if I may, I'd like to set up on your easel, and if I could speak from them, I would appreciate it.

Mr. DeCONCINI. That's fine, please proceed.

Mr. EHMANN. Although we are not in a position to only consider the traditional Mafia approach in organized crime, but we're considering during these hearings organized crime in general, as a generic

problem. Fortunately for us and perhaps unfortunately for the traditional crime organizations we've had a number of years to study them, and I believe they represent proportionately the kinds of problems we're dealing with. I believe it would be helpful to discuss this ever so briefly so that we can see how it reflects in Arizona.

Approximately two dozen organized crime families are generally recognized of a Mafia-type in the country. It's fairly obvious to see that the concentration has been, for a number of years, on the east coast: Five of the families being headed in New York and the rest of them spread out. Again, a concentration on the east of the Mississippi. In the west several families are recognized, one in Colorado, a few in California. The profile of the families, particularly in Colorado and here in California, has been significantly different from the profile that has been established for those east of the Mississippi.

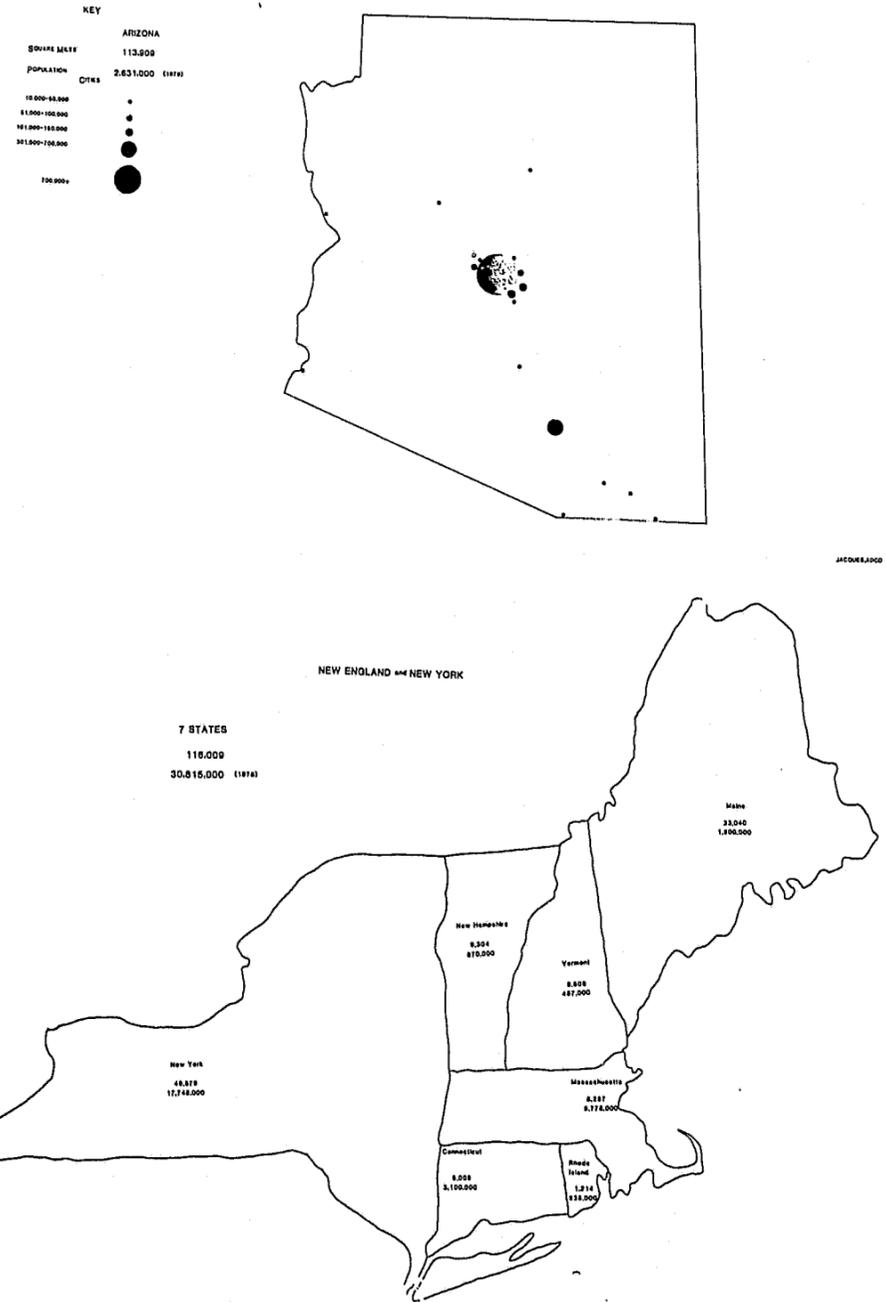
A looser conglomeration of thieves and criminals, a much greater use of the nontraditional Mafia figure within that family; in other words, they're subcontracting a lot of work to a greater extent than those individuals on the east coast. Now what we're dealing with in all of those families, estimated by law enforcement to be somewhere between 6,000 to 10,000 Mafia-made soldiers or warriors, as they would call them, the greatest proportion of those individuals reside and operate within the area east of the Mississippi, generally extending from New York City and moving over into Illinois.

As you move from the East to the West the profile of the organized crime families vary considerably, and the difference between east and west is considerable. It's our theory, without attempting to categorize to the point that we restrict ourselves in our thinking, that the organized crime difference is similar to the sociological difference that may exist between the States themselves on the West and the East.

The size of the States on the eastern part of the United States is smaller than the size of the States out west. The development in certain areas, particularly as population has slowly moved west, has also proportionately been different. We have large States out here, some of which are larger than several other States back on the east coast.

I have a chart here which will illustrate that. This is an approximate map of Arizona as it exists, and with the greater metropolitan masses. Of course, Phoenix in the greater metropolitan area and its relatively larger cities, and Tucson with its other large metropolitan mass. When we consider the State as a whole we have approximately 2 3/4 million people that reside in the State. Our State is about 113,000 square miles, and that's significant to us, because when we compare that to some of the things that go into the east coast States, it will illustrate, with this overlay, the six New England States and New York in total size are only 3,000 square miles larger than the State of Arizona. This, again, is an approximate, proportionate map which overlays the six New England States and New York over Arizona.

ARIZONA



As you can see by fitting the various parts in the blank spots that exist, what we're talking about here is a population base in the New England-New York area of about 31 million, 32 million people being squeezed into a geographical area approximately the size of Arizona. The obvious nature of the crimes that has evolved has been exactly that: more obvious and more identifiable.

Organized crime, whether it be the Mafia or other organizations which are similarly intruding into our life through criminal activities, have been identified because of some of the strong-arm tactics, some of the methods that were used in the New England and New York area during the early part of the 20th century: loansharking, some of the vice crimes, very obvious, very overt crimes through which they made a great deal of money. The same has not been true for us in Arizona. What has happened for us in Arizona is that because of the relatively smaller size of population in a relatively larger State, the sociology of the State has prohibited individuals coming from outside or within and imposing upon the citizens of this State the same kinds of crimes that have occurred traditionally back East. The strong-arm tactics haven't worked out here.

The western mentality, the wide-open feeling of the State and of the sociology have prohibited that. So what has happened, particularly in the last 30 years, is that some of the individuals within the State and from without the State have studied humans, and in studying the humans within our State have determined that the same methods would not work in Arizona as have worked on the east coast.

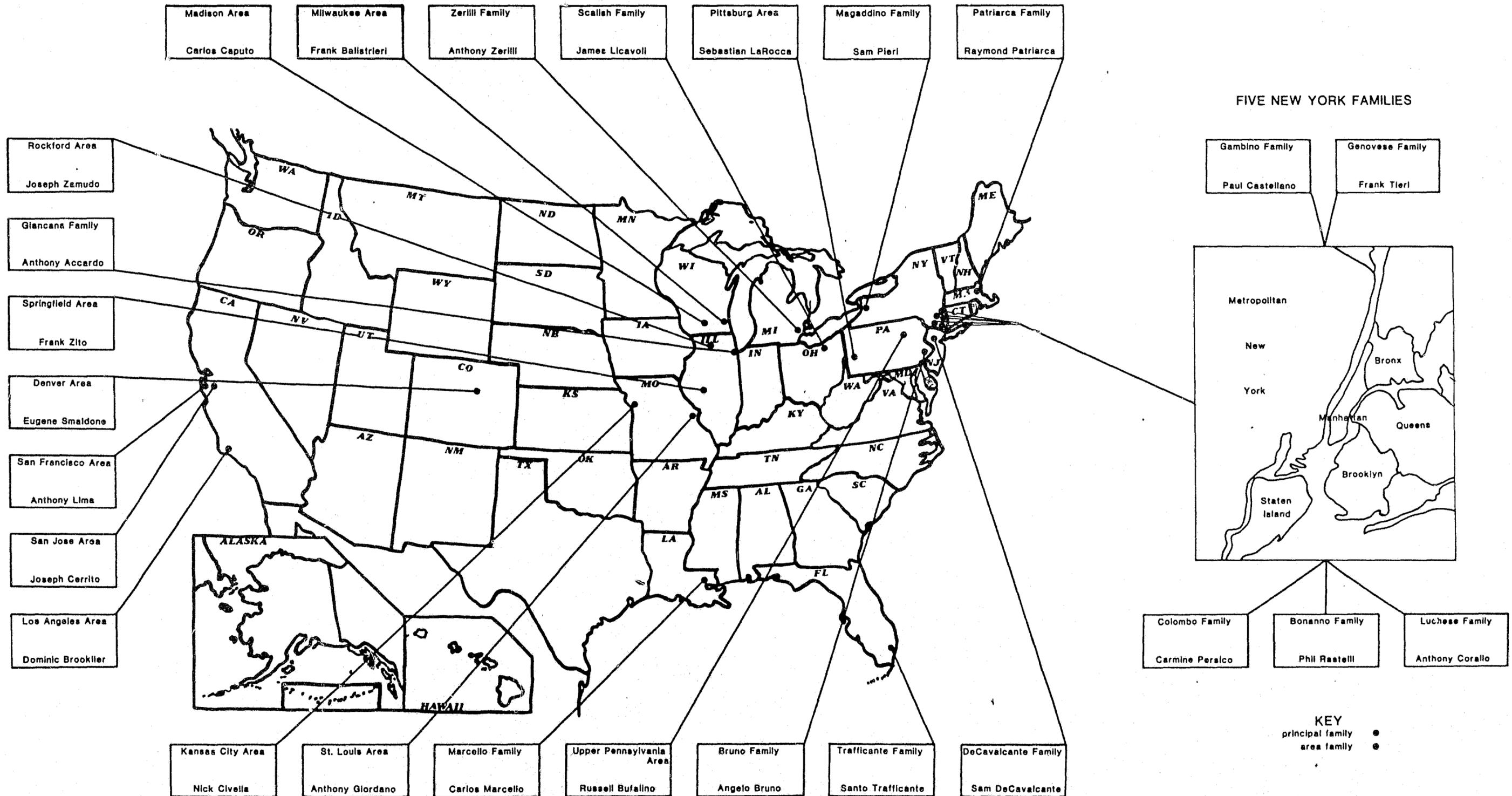
Thirty years ago some of the traditional organized crime people and the Mafia, particularly, since we're using them as illustrative of what we're talking about, moved into our State. They bought land. Individuals, for instance, from the Zerilli family out of Detroit, individuals from the Bonanno family, people from the Chicago area, the Accardo's, and other people from that area came in, bought land, are operating legitimate businesses based on that land usage in our own State.

[An illustration showing organized-crime families in the United States follows:]

# CONTINUED

# 1 OF 3

# ORGANIZED CRIME FAMILIES IN THE UNITED STATES



What is illustrative, I think, also of this map is that many times people will state that sometimes as high as 85 percent of the land in Arizona, in this whole area, is Government owned; that in some way the Indian reservation or Federal or State lands is owned, and so that we only have 15 percent of our land. People have a difficult time understanding why they would come into this State to perpetrate, for instance, land frauds. If we look at it from this perspective of the overlay, we can see that we would have about 20,000 square miles of land if we only represented ourselves to have 15 percent available for usage; that's larger than Vermont and Massachusetts and Connecticut put together. That may put into proportion for us to a greater extent why it is that people come to our State.

Our State, typically, has not reacted to the importation of the other State criminals and to other State citizens that have moved here, as you indicated, for the same reasons everybody else does, for the weather, for the standard tourist reasons, for the availability of certain things in our State that aren't available back there: the land, the wide open spaces. We have not rejected that. With the mentality that exists in Arizona, the "welcome everyone in" we have allowed, unwittingly, a number of people to entrench themselves into our society.

At the same time, I don't believe the legislation in our own State has typically acknowledged the kinds of crimes that were being perpetrated under our noses, the kind of entrenchment through the corporate structure, through some of the land fraud schemes and mechanisms which have been discovered over the last 15 years, 10 years, more specifically.

Additionally we have, as a problem for us, in some instances, a rather wide or rather large border area, totally around the State. Also we have about 360 miles along the lower part of Arizona which is tangent to Mexico. Typically, that is very good for us, but there are organized crime problems that occur as a result. There have been identified 27 or 28 different organized crime families that operate for narcotic purposes, major families between Arizona and Mexico. These are nontypical Mafia families, they are Mexican Mafia, sometimes called, but they are narcotics importers and purveyors, and what we have been finding is that not only are they relating between our State and the other four States involved in our project, the four-corner States and Nevada, but also that what they are doing is they're utilizing our funds from illegal narcotics activities to finance other kinds of illegal activities: land fraud perpetration, corporate schemes, and so forth. So by virtue of our large size and our small population density and the reluctance on the part of our citizens to try and forestall the organized crime tactics that have taken place from those people who have intruded on us from outside, our legislative process has been somewhat sluggish in recognizing some of the more sophisticated schemes that have been taking place.

The response on our part has been to organize a number of crime-fighting mechanisms including several multistate regional projects. While recognizing that we're not fighting a very defined problem, that while we see what it is that traditional Mafia crimes have included, and while we have included those, usually after the facts, we really don't know precisely what it is that this other type of organized crime

is doing to us, and that's exactly what's happening, they're perpetrating acts against us, and typically, law enforcement, unfortunately, has been having to catch up with this after the fact.

One of the things that has evolved almost naturally has been the development of a number of multistate regional projects, which include these areas which are outlined with different colors, and the way that these outlined areas came about was through common communication among those areas, determined that these areas were suffering from similar types of problems.

So what has evolved almost naturally over the last 5 years and accelerating within the last 1½ to 2 years is the development of some of these multistate regional projects which are organizing themselves toward a common purpose, and yet all with the common end of fighting this organized crime problem, whether it be in narcotics or the traditional crime area, white-collar area, or whatever. The advantage of these has been for us that there is some autonomy and some individuality given to the problems within the particular areas. For us to view that there is a single problem or single common problem that exists between the east coast and our own State, for instance, would be rather foolish. We can't apply the same techniques toward investigation or prosecution that are applied back on the east coast, it simply hasn't worked, and it won't ever work. So while we have to look at the whole country as being pertinent to our problem, we also have to view the fact that Arizona is singular and unique, and some of the areas that we have discussed here so far, I believe, gives some credence to that.

The main tie-in component that exists, the continuing of thread here and among all of these projects is basically the end toward combating organized crime in the broadest and most generic sense of the word, and by using common communications to do so.

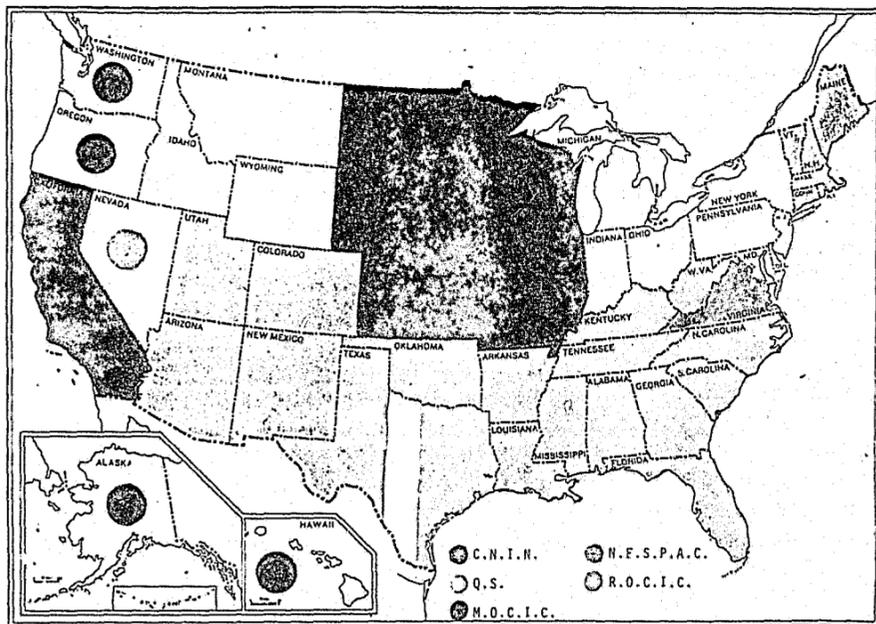
So while we have been able to identify some problems that may overlap from one area to another, we haven't been able to continue the communicative method within the projects themselves. That, for us, has been very critical.

Senator DeCONCINI. Can you identify the different multistate groups there?

Mr. EHMANN. Yes, sir, I can. The States outlined in yellow are known as the Western States Information Network and include Hawaii, Alaska, and all of the Pacific States. The Quad State was known as the Quad State for its four States, Arizona, New Mexico, Colorado and Utah, and have recently been joined by Nevada, and are soon to be joined by west Texas.

The Mid-Western Organized Crime Information Center is what is depicted by the blue outline there, and includes all of those States in the Central, Northern part of the United States. The Regional Organized Crime Information Center, which is headquartered in Memphis, Tenn., and, in fact, the oldest of these such projects, includes all of the Southeastern States from Texas all the way up to West Virginia and Virginia. There is a forming project right now in the Great Lakes-Atlantic area which will include everything from Indiana all the way over to and including New Jersey.

[Illustration of multistate crime fighting groups follow:]



In the Northeastern part of the United States is the New England Police Administrative Council, which include the six New England States. Each of those areas has seen a different particular problem that has emerged. In the New England area, for instance, they have had a lot of arson problems. Something, by the way, which is beginning to emerge in both Phoenix and the Tucson area, obviously organized-crime related, and all of the fires that have been perpetrated, specifically insurance, fraud, and that type of scheme, have been identified with organized-crime efforts.

In the Southeast, their project developed as a result of what they refer to as the Dixie Mafia, a non-Italian, nontraditional Mafia organization, but was a rather vicious traveling criminal problem throughout the Southeast, and there was no effective way on a local basis to deal with the problem that had emerged, so these States banded together rather casually, established a communications network and began exchanging information about some of the local criminals who would leave prison and immediately began perpetrating crimes again in the Southeast.

So it was in 1972 when the ROCIC emerged, and it was on that model that many of the other groups have patterned themselves.

It has come to our attention rather painfully that not only are we at a point here in Arizona where we believe, without being too dramatic, that we are ready to go one way or the other, that we are going to be realizing the same kinds of problems that the east coast does, and for very selfish and jealous reasons we don't want that to happen, but also that we really aren't precisely sure what the problem is. We have discovered that part of the problem is white-collar crime; these are the more sophisticated crimes. We are the answer for organized crime in Arizona, because the more overt kinds of crimes that we

identified years ago have been stopped. What else is happening, we're not sure, but we believe that part of the answer is not only some of the solutions that I would offer here, but also identifying, if we can, what organized crime is up to.

Senator DeCONCINI. Is the Quad State effort, at least in Colorado and Arizona, directed more toward narcotics or general organized crime activities?

Mr. EHMANN. The project itself was designed to accommodate both narcotics and organized crime. The Colorado component has within it both organized crime and narcotics investigators who work hand and glove, as is the case in Arizona. What we have seen in Colorado, for instance, is that one of the traditional organized-crime families currently led by the small dons, has involved itself in both kinds of organized crime, the kind that existed on the east coast from loan-sharking to white-collar crime and narcotics activities. It is particularly there we have seen that the financing of other crimes has occurred through the profits made from illegal narcotics activity. Arizona has been concentrating its efforts in both areas. The primary interest has been toward narcotics, but we have increasingly seen that other types of organized-crime people and figures are financing these narcotics activities. Almost unwittingly we find ourselves drawn into the arena of having to fight more types of organized crime by virtue of that involvement.

Mr. DeCONCINI. Thank you very much, Mr. Ehmman.

**STATEMENT OF WILLIAM SHAEFER, REPRESENTING OFFICE OF ATTORNEY GENERAL, STATE OF ARIZONA**

Mr. SHAEFER. Senator, I too want to thank you for the opportunity to participate in these hearings, and to say a few words about the threat of organized crime in Arizona and the response that has been mounted in years past.

I have been in Arizona for 20 years and I have been a prosecutor for more than that. I came to Arizona from the Department of Justice. I want to talk this morning about prosecution in Arizona and our posture in the past and perhaps something about the present posture in regard to organized crime.

I think it must be obvious to anyone who is familiar with law enforcement in Arizona that until very recently we have been ill-equipped to handle anything of the magnitude of organized crime. When I say "ill-equipped," I speak of something more than hardware; that too has been a handicap in the past and perhaps is still a handicap. A few years ago we did not have a State crime lab, and a few years before that we probably had no crime labs at all that were capable of sophisticated analysis work. Hardware was a problem, but we were ill-equipped, in my estimation, in more important ways: we lacked coordination, and we lacked sophistication.

I have been prosecuting in Arizona since 1961 and until the last few years the statewide prosecution effort has never been united and has never been able to mount an effort to meet something like the challenge of intelligent, organized, and sophisticated criminals.

Traditionally, State prosecution offices in Arizona have been provincial. We didn't know in years past what organized crime was, we

didn't know an organized criminal when we saw one, and we didn't know how to detect what he was doing, if he was doing anything. We not only didn't know, it seemed as though, and I'm sure it was true, that we didn't have time to know or to find out. We were busy taking care of the normal street crimes, we were constantly understaffed, our trial schedules were always overcrowded, most of us were part time until very recently. We didn't know what any of the other counties were doing in the same areas we were working in every day. A few county attorneys had investigators and we had no regular or permanent grand juries. A 2-week trial was a long one, and if someone had told us some years ago that we were going to have to be in court on one case for 2 months, a number of offices would have had to practically fold up. They could not have accommodated that. But worse than this, I think, was the fact that we had no one to help us who was appearing on the horizon, and no one out there was telling us what was waiting for us just around the corner. There was no preparation for what was to come. No one had planned, and very few had had the time or the inclination to look ahead to see what other areas had encountered and to predict what was going to happen in Arizona.

Once it was known that there was a thing called organized crime and we, the prosecutors, saw it in our back yards, we realized how ignorant and ill-equipped we were, we also realized that we had better do something.

But what? That was the question. One or two offices created what were really informal special units of experienced prosecutors to concentrate on organized crime-type cases. I think it is probably true that where those units existed the people who were in them had never really tried what we might call an organized-crime-type case. That kind of obligation usually fell to those who had been in the office the longest or had the most experience, and it simply gravitated to them; there were only a few of these, and they were really informal and they were composed of only a handful of men. There was not the time and effort and money to do more than that. And very few of these people, I believe, knew anything about organized crime. What they did know, it seems, and I happened to be one of them, was mostly things that they had taken away from seminars and conferences in Chicago and New York that were put on maybe once or twice a year. And these people were not working full time at organized crime even within that office for those units, and they, too, were doing it after they had finished with the rape and murder cases and the burglary cases and the arson cases that just wouldn't wait.

These efforts, unfortunately, really accomplished very little if anything. They did, however, heighten the realization of how little we really did know and how little we were prepared. Our sophistication took an upturn with the advent of LEAA money. That money permitted us to purchase tools that we never had, and it allowed prosecutors to organize a bit more and specialize a bit more, but that was only a beginning. As all of us knew, the LEAA money, and similar types of money, were really seed money; it was still up to us to put together some kind of an organized and sustained effort.

In the early 1970's, the Arizona attorney general's office created for the first time a criminal division, that was also incredible to me that there had not been a specialization within that office.

Yes, Senator?

Senator DeCONCINI. For the record, did that take statutory enabling legislation to create?

Mr. SHAEFFER. The criminal division?

Senator DeCONCINI. Yes.

Mr. SHAEFFER. No, it did not, Senator. That was done within the office. And it was done in the middle of 1972 and had not—the criminal work in the attorney general's office before that time had been done by a number of people who, perhaps, concentrated on it, but it had not been really that much of an organized effort.

Senator DeCONCINI. Is that when you became the head of that division?

Mr. SHAEFFER. Yes, in 1972. At the same time, around the same time, the attorney general's office also set up a fledgling unit to combat organized crime. It really had three men, and it obviously was understaffed and undermanned. It lacked direction because of the same overall problem of knowing in what direction we or it should be going, and it seemed as though it was really pushed out to sea to sink or swim on its own. It practically had to be in the atmosphere that existed at that time. Well it sank within 2 years, really. It never got started, and it probably made no difference at all in the overall effort except to be a precursor in the beginning.

Senator DeCONCINI. To what do you attribute the sinking? Lack of support from the legislature, the community, other law enforcement agencies? Why did it sink?

Mr. SHAEFFER. Senator, I would say first of all I believe and I think this was the main thing, the other things just fell into line. There was little understanding of what it had to do, and the direction it had to take, and I believe at the time if we could have been more sophisticated and realized what we should be doing and had some things pointed out, that we could have gone for legislation. We could have gone, perhaps, for more money; we could have gone for specialists in certain areas of prosecution. That wasn't done.

Senator DeCONCINI. I see. Thank you.

Mr. SHAEFFER. Still there was no statewide concentrated, coordinated effort. Now I think from all of these things that the lesson that has to be drawn from these abortive efforts is an obvious one. We knew, we realized that we had to get organized, and that really had to be this week that the organization took place. We've got to have prosecutors who know the intricacies of an organized crime case, we have got to have prosecution offices that are large enough to investigate and try long and complicated cases, and we have to have an ongoing and sophisticated method of collecting and disseminating information of organized crime activities. That to me is extremely important, and organized crime is just one of the areas where that has to take place.

Senator DeCONCINI. Do you have that today, Mr. Shaefer?

Mr. SHAEFFER. I believe it is developing today, Senator, but—

Senator DeCONCINI. In the attorney general's office?

Mr. SHAEFFER. The attorney general's office is one; I believe what Gene has talked about is another area where that can be developed.

Senator DeCONCINI. Would you say we have come a long way in the realization of the problem from the standpoint of the prosecution?

Mr. SHAEFFER. Oh, yes, I believe that's true. That seems to have happened in the last few years, and I think that really is the first step, that has to be done; it has to be realized, and computers themselves. I use the word "computer," that to me is perhaps a word that takes into its aegis everything that could be into some kind of an automated system to collect and spit out information. That is a very new area, and I think that is an area that most prosecutors, most law enforcement agencies that deal with prosecutors every day have not been familiar with until very recently. We are experimenting with those now. We're just beginning to see how that can be expanded to fulfill the function that we think something like that has to fulfill.

One ancillary area that I'm very familiar with currently is the death penalty. That does not exist in death penalty cases; unfortunately, it should. It's the same thing with organized crime. We're beginning to realize that perhaps we can collect some of that information and we can make it available to many more people than was ever possible before. And I believe that we have made efforts and we are making efforts; however, it's going to require more than we currently have.

I doubt very much if we can do this on our current budgets; I believe we will need help. I think there will have to be an infusion of Federal money for men and equipment, but money alone will not do it. I think that has been one of the mistakes in the past with Federal money; too often it seems that the money has been given and received with little realization by either the giver or the receiver as to how it could and should be used most efficiently.

There was not enough education to go with it. It will not do that much good to give money to set up a unit of organized crime prosecutors if they are not first instructed what organized crime is, where it can be found, and how one spots it when he sees it, and then once he knows what it is, what he does with it, and how he gets it to court.

And I believe there is one overriding thing even with the realization and the sophistication, and that is that nothing can really be accomplished without a leader, without someone, without some agency that can galvanize the people into the effort that's needed. We have, I think, begun on that task, but there is still quite a ways to go.

Thank you, Senator.

Senator DeCONCINI. What is the monetary amount that the State spends in your area of organized crime?

Mr. SHAEFFER. Senator, I would have to leave that, I believe, to the further witnesses to come. Mr. Corbin and Mr. McDonnell could probably address that better than I could.

Senator DeCONCINI. In your experience of this evolution toward awareness and sophistication, do you find a need to have cooperative efforts with all law enforcement, and what is your overall judgment of that cooperation in Arizona?

Mr. SHAEFFER. The answer to the first question is without question; there must be, and there must be a regular exchange of information

and ideas and programs. And, again, I don't think there is any question, I don't think anybody would dispute this, that within the last few recent years the cooperation has been very good, it has existed in the last few years like it never has before. We find people talking to each other who didn't do it before, either because of the distances involved or simply because they had never done it before.

Senator DeCONCINI. Is there a vehicle for this cooperative effort or is it just an effort by the Attorney General's Office and other law enforcement agencies possessing this awareness that you talk about, to get on with doing the task?

Mr. SHAEFFER. I think there are a couple of vehicles. The attorney general's office has done much more in the last few years than it ever had done before, but there are also vehicles for the individual county prosecutors to get together; they now have an association which they had before, but it wasn't the association it is now, and it's an ongoing, dynamic association in that they do exchange things. They are able to mount a legislative program, for instance, which we can all remember which was not true a few years ago, it was not an individual basis, and they can inaugurate programs in conjunction with the Attorney General's Office and with the Federal prosecutor's that was never able to be done before. But there are limits again to staff and money.

Senator DeCONCINI. Thank you. Do you have any estimate or shall I wait and ask the Attorney General about the monetary amount of Federal funds you're making reference to?

Mr. SHAEFFER. No, I prefer you address that to the Attorney General, Senator.

Senator DeCONCINI. Thank you.

Do you have anything further?

Mr. SHAEFFER. No.

Senator DeCONCINI. Mr. Smythe.

#### STATEMENT OF JACK SMYTHE, REPRESENTING THE FEDERAL BUREAU OF INVESTIGATION

Mr. SMYTHE. Mr. Chairman, I would also like to thank you for the opportunity of appearing here today, and I hope that the comments that I have will be beneficial to your inquiry. I think that Mr. Ehmann and Mr. Shaefer have illustrated that awareness is a major factor, and I think they've shown that organized crime is alive and well and living in Arizona.

What I would like to do is sort of present to you some thoughts that I have from the standpoint of the investigator.

Congress, of course, enacts legislation and it filters down to us, and then we implement that legislation, and then we run into the problem of how to effectively bring the thought of Congress to prosecution and to impact upon our community in those areas so we are striving to handle the legislation. Admitting or understanding that organized crime is active in Arizona, I would like to touch on some of the things that we have found in our investigative efforts that illustrate what they are doing in Arizona.

You are particularly interested in bankruptcy fraud, and bankruptcy, frauds are extant in Arizona. We have had instances where

bankruptcy frauds have been perpetrated and individuals have been prosecuted; I believe the U.S. attorney will touch upon that aspect.

There is a new bankruptcy legislation that has been implemented recently, we haven't—I really can't comment on the impact of that at this time, because we haven't had enough of a track record to really understand what the full implications of the law are and how we will be affected. Probably as we have more contacts in that area we will be better able to assess how it is working.

Other areas that we found, particularly in the financial crimes area, and I might point out in all of the areas of criminal activity that I am going to touch upon, there is generally concurrent jurisdiction between local and Federal authorities. Another area would be land frauds which were brought to public attention here in the past few years; there has been a strong, concerted effort by local and Federal authorities in this area which has impacted favorably. I think, upon the community, but we find many of the same individuals who have been involved in the land frauds are now moving into other areas such as franchise frauds, and this is an area where we are having more contacts with the organized-crime-type figure.

Another area in financial crimes would be front-end loan scams; this is the type of fraud that is prevalent in Arizona. If I had to point out what we in the FBI feel is the largest area of organized crime involvement in the State of Arizona, I would say investments of capital into legitimate businesses is an area where it is very difficult to pinpoint the economic impact upon the citizens of this State.

If you consider the economic situation today, when mortgage money or capital for investment is limited in legitimate channels, the opportunity of an individual who has created large liquid assets through racketeering activities in an Eastern State, who comes to this State and invests in businesses, in land, in restaurants and bars, and so forth, how this impacts upon our community is almost impossible to understand.

However, we know it is happening. We have legislation, the Rico Statute, and the State of Arizona has recently passed legislation very similar to the Federal statutes which attempts to cut off the investment of capital in legitimate businesses. However, the prosecution and the investigation of these crimes is extremely difficult due to the nebulous nature of the activity.

Aside from financial crimes, we do find that racketeering goes on on an incidental basis by organized crime in Arizona: Extortion of credit transactions, gambling, prostitution, and so forth. Drugs is a major problem that I think Mr. Ehmann had pointed out earlier. We haven't found any significant control over racketeering in the State of Arizona by the traditional La Cosa Nostra organized-crime families.

However, we feel that as the population growth in the State of Arizona continues to accelerate that the very definite possibility does exist, that there will be encroachments by the traditional organized-crime families into racketeering in the State of Arizona.

Another area where we have involvement by organized crime is in the area of arson. Arson is becoming a problem in the State of Arizona. A little further along I would like to illustrate an arson incident that involved the FBI and local authorities in Arizona.

Now, in recognizing an awareness on the part of people that organized crime is here, that they are involved in illegal activities, is the first step; that when the public is aware of it, when legislators are aware of it and they become alarmed at it, then possibly effective action can be taken by the investigative arms of the law.

There are certain tools which we do have to combat organized crime, probably one of the most important and particularly in this period of budgetary restraint on all levels of government is cooperation between all law enforcement agencies actively involved in combating organized crime. We of the FBI and in the State of Arizona are aware of the need for cooperation. We're outnumbered. Our resources are limited by budgetary restraints and we must cooperate and I think together we are making great strides in Arizona in the area of cooperative efforts.

There are certain tools—I think earlier on, Mr. Chairman, you mentioned the question of privacy rights versus the societal rights, and the swinging of the pendulum back and forth. In combating organized crime I think we touch very strongly in that area. In reactive crimes, a bank robbery or so forth, when the investigator goes to the bank and asks: "Has a crime been committed, and which way did they go, what did they look like," witnesses actively cooperate, descriptive information is obtained and when prosecution is forthcoming, the witnesses come forward readily to help in the prosecution.

However, in organized-crime investigations this does not seem to be the case. In many instances there is no awareness that a crime has been committed, and the uncovering of the crime is based upon the effort of the investigator himself. If the organized-crime investigator remained in his office and waited for people to come in and tell him that crimes have been committed, I think he would be sort of like the Maytag repairman. He wouldn't have many callers. So it's incumbent upon the investigative agency to go out and actively seek the crime, in order to do this there are certain techniques that have to be utilized, which bring into question the privacy issue: Informants, the utilization of informants is one area.

Yesterday I was talking to our investigators regarding the bankruptcy frauds, and asking them what is the major problem in the area, and the answer was that we don't know the crime's been committed until the horse is gone. When a bankruptcy bustout scam is being perpetrated the individual comes in and he borrows on short-term loans, and he pays off small-amount loans, and building up his credit rating for the big kill. So we never know that a crime is imminent until it has occurred.

The only way in the bankruptcy area we might be forewarned is to have informant information that somebody is anticipating this particular action, then the possibility exists to conduct an investigation and be ready for the bustout when it occurs.

Another area of investigative needs is electronic surveillance. The State of Arizona has a law providing for court-monitored electronic surveillance, the Federal court has title 3, which allows us to conduct court-monitored electronic surveillance. This is essential to actively getting to the major figures in organized crime. The top figures in organized crime do not get out onto the street and handle the confrontations which can be monitored by law enforcement on the street level.

A third tool again—in going over these, all of these are currently under scrutiny and consideration in Congress. I believe, as to its impact upon the privacy issue itself—a third area is witness protection. In instances where witnesses are reluctant to testify for fear of reprisal, the only alternative is to have a system which allows for the Government to bring people under their protection and to relocate and to provide them with new identities. In many instances the witnesses are criminals themselves, and there is a grave concern about placing criminals from one community into another, but this is an essential tool to effective combating of organized crime.

A fourth technique is the investigative grand jury. I think this is positively essential. There is consideration again today being given to the grand jury system. It's vitally important to organized crime prosecutions.

A fifth technique is the undercover operation. In Phoenix there have been joint undercover operations and there have been undercover operations undertaken by individual agencies, all of which have been effective in getting at criminals who otherwise might not have been detected.

I mentioned arson earlier. We had an investigation that seemed to illustrate all of these techniques and how they can effectively be implemented into combating crime. A local individual in Phoenix, Ariz., who owned a restaurant and bar fell on hard times and he wanted to collect insurance for an arson of his restaurant, so he contacted a friend of his, an associate of his, in a large eastern city, who is going to put him in touch with an arsonist who handled the job. The arsonist who he selected to handle the job was an informant of the FBI who was involved in an undercover operation at that time, fronting the undercover operation. And he gave to the informant the contract for the burning of the restaurant in Phoenix, Ariz. The informant traveled to Phoenix, conversation between the individual who wanted his restaurant burned and the informant were electronically monitored, gaining evidence as to the intent of the individual and the involvement of his associate in the eastern city. The result was that the arson was forestalled, the individual was convicted and sentenced to jail, and the individual who had arranged for the arson was convicted also, and went to jail. The informant was then placed under the witness protection program, and was taken out of his contacts with his former individuals and associates. This, I think, illustrates the importance of these techniques and how their utilization is necessary.

In conclusion, I might touch on two things that I feel inhibits effective law enforcement in this area. We in the FBI are cognizant of privacy issues; we feel strongly that the rights of the individual should be protected. At the same time, we need to be able to protect society and impact in the combating of organized crime.

One area that we are having difficulty in is the implementation of the Freedom of Information Act and the Privacy Act. Personally, in my contacts with individuals in organized crime investigations and the investigators of the FBI, we have had direct contact with people who have refused to provide information for fear of disclosure under the Freedom of Information Act and the Privacy Act.

A second area is the right to financial privacy laws, and in the area of economic crimes, access to third party records is essential to proving the flow of organized crime money, the extent of organized crime money. And the burden placed upon the court in implementing the right to Financial Privacy Act is burdensome, and it's difficult for the investigator in his efforts.

Well, I have nothing more, I hope I have been of some help.

Senator DeCONCINI. Yes, you have. Let me ask a couple of questions. You made some reference to a growing number of prominently known, identifiable people in organized crime who are moving to Arizona. Is Sal Bonanno the kind of person or individual you are referring to? Is there evidence of a growing exodus of organized crime figures from other parts of the country to Arizona?

Mr. SMYTHE. It's hard to answer that question. I wouldn't say that we would see a high level of organized crime figures coming to Arizona for the purpose of implementing racketeering or the placing of a group of soldiers in the community. However, I think the way it will be done would be for associates—the Cosa Nostra has its membership and its leadership and structure. These individuals are the benefactors of the organized-crime activity in their specific community, and it wouldn't be the type of thing that they would want to do, to come to a new area and start the program going. However, associates of these individuals would; they would come, say, to Phoenix, Ariz., and then with the blessing and the support of, be it monetary, be it the need for muscle on a given occasion—

Senator DeCONCINI. Is there that kind of organization here now, associates from recognizable organized crime families, or entities, that do operate in Arizona under some kind of direction or some kind of tacit approval from outside the State?

Mr. SMYTHE. Yes.

Senator DeCONCINI. Is that the trend that you are referring to—or that I am referring to—that is growing?

Mr. SMYTHE. That is the trend I am referring to.

Senator DeCONCINI. How much has it grown in the past 5 years, in your opinion?

Mr. SMYTHE. I think that the Don Bolles murder had a restraining effect upon this. The media involvement following that murder, the investigation put a lot of heat on, and it inhibited the growth. But I think that—

Senator DeCONCINI. Prior to that, what was your observation?

Mr. SMYTHE. Prior to that, I don't think Arizona was that attractive. The population growth in the past, what, 5, 6, 7 years is the major factor, and I think that right now—someone earlier said that we're at a crossroads now as far as organized crime is concerned.

Senator DeCONCINI. Does the FBI have a list or the ability to estimate how many of these operations are actively being pursued now in Arizona? I am not going to ask you for the names; I just want to know how far you have gone into it.

Mr. SMYTHE. Well, we are in the process of upgrading our ability to know when they're here. We are surprised, quite often, that—

Senator DeCONCINI. When they are here?

Mr. SMYTHE. That they are here.

Senator DeCONCINI. And quite often you don't know what they're doing?

Mr. SMYTHE. That's correct. We then institute investigations to find out.

Senator DeCONCINI. How many investigations on what you would consider significant organized-crime entities or individuals do you have going on in the State of Arizona?

Mr. SMYTHE. I wouldn't like to comment on that.

Senator DeCONCINI. Do you have active investigations in land fraud and bankruptcy fraud?

Mr. SMYTHE. We have active investigations in land fraud; I believe they're running down at this time. We do not have any active—let me qualify that. We have a few investigations in the bankruptcy area. It is not one of our major problems; it is something that we are aware of and are concerned with, but it is not the major investigative problem that we have.

Mr. DeCONCINI. Do you have any estimate or can you help the committee have a better understanding of the dollar amount of money and of investments of illegal dollars made into legitimate businesses in Arizona? Are we talking about hundreds of thousands or hundreds of millions?

Mr. SMYTHE. Sure, talking about hundreds of millions, but I cannot give you a figure, because I would say that probably every week I am informed of another individual who has an investment in the State of Arizona that we aren't aware of. The problem in that is that you know there are no contractual arrangements between the front individual and the man who actually puts up the money, the man who is fronting it—all the paperwork is in his name, or associates of his, but the—the man who actually put up the money, he gets his percentage.

Mr. DeCONCINI. You say you don't know exactly, but I gather from your testimony you think it's a growing problem and it's happening more frequently. Is that a fair statement?

Mr. SMYTHE. That is correct.

Mr. DeCONCINI. You do think it may be in the hundreds of millions of dollars. What is the FBI doing, without designating specific people or cases, to combat or investigate it?

Mr. SMYTHE. We have active investigation under the RICO statute.

Mr. DeCONCINI. Now, under the RICO statute in Arizona?

Mr. SMYTHE. In Arizona.

Mr. DeCONCINI. Mr. Smythe, often it's been mentioned to me and other Senators that the FBI does not cooperate wholly with local and State law enforcement officials. There are exceptions, of course, and I know of some. What is the attitude of the FBI here? What is your policy? Will you do a joint case with a local prosecutor or a local police department, or do you have any policy or direction that it has to be run completely by the FBI?

Mr. SMYTHE. No; our policy here is to seek out joint investigative efforts.

Mr. DeCONCINI. And you do participate in those efforts?

Mr. SMYTHE. Yes, we do.

Mr. DeCONCINI. On a regular basis?

Mr. SMYTHE. Yes, sir, on a regular basis.

Mr. DeCONCINI. I have no further questions.

Gentlemen, thank you very much for your oversight of the problem. I appreciate your time and thank the agencies that permitted you to be here today.

[Whereupon, a recess was taken.]

Mr. DeCONCINI. Our next witness is the distinguished attorney general of Arizona, Robert Corbin. Thank you, Bob, for your assistance and cooperation with these hearings. Mr. Corbin is accompanied by Phil McDonnell, assistant attorney general.

**STATEMENT OF ROBERT CORBIN, ATTORNEY GENERAL, STATE OF ARIZONA, ACCOMPANIED BY PHIL McDONNELL, ASSISTANT ATTORNEY GENERAL, SPECIAL PROSECUTION DIVISION**

Mr. Corbin. Thank you, Senator, for giving me the opportunity to testify at these important hearings today. Organized crime and bankruptcy fraud are two very serious problems facing the people of Arizona.

Some of the things that we have done in an attempt to try to get into this area was that we've wanted to do like the Government did a number of years ago with the Capones and those kinds of people. It's very difficult to prove that the higher echelon committed murder or burglary or anything of that nature. We felt that the best way to get them is through their income or sales tax areas, because those people who are in organized crime, making illegal moneys, just in most instances aren't reporting it.

We did go to the legislature last year asking for more people, investigators in particular in that area, because that's a fairly simple thing to investigate and prosecute, you either look at their records, and you can observe the people who go in there and things of that nature, see if they're reporting it on their sales tax, but we didn't get any. There is only one investigator in the State of Arizona to work income tax, and there is none for sales tax.

Senator DeCONCINI. Is that in your office?

Mr. Corbin. No; it's under Revenue. Phil has nine investigators on our budget, and last year we took two of them to work in the sales tax and income tax areas, because there wasn't anybody else doing it, and unfortunately or fortunately, whichever way you wish to look at it, no one else in the State has the jurisdiction to even see sales tax or income tax records, and I cannot even discuss by statute those cases under investigation or not under investigation under the State law. We were given one attorney, and I don't know what good that one attorney is going to do us in the office, because he's not a trained investigator, so for that reason we did put two of our own investigators who were working white-collar crimes to work sales tax. We have got a few indictments, and there are some more under investigation right now, but I won't name who they are because I can't.

In addition to that we went to the Department of Public Safety, Mr. Hoye, and asked if Mr. Hoye could give us some people, because we didn't have them, to get into the organized-crime area where it was involved statewide. He was nice enough to give us seven of his people, he brought them out of other divisions of his office to work with Phil's unit in the organized-crime area.

We have seen recommendations from the two, the only two budget committees to the legislature to decide what to do with those seven people; one of the budget committee recommendations is to send four of those people back to their regular assignment, leaving us three, and the one that the legislature usually follows has recommended that all seven go back to their duty assignments.

So at that particular point in time we're not going to have any investigators either in our DPS or in my office to work the organized-crime area in the State of Arizona.

Senator DECONCINI. Excuse me. Bob, is it safe to say that there is a lack of support or lack of awareness on the part of the legislature when it comes to funding this type of effort?

Mr. CORBIN. I would have to agree with you, Senator, that that's part of the case, and that's why I welcome this hearing.

Senator DECONCINI. Why do you think that is the case?

Mr. CORBIN. I think there are many reasons, Senator. To be quite honest with you there are people who don't want to see me get people, because they're afraid politically or whatever it may be. There are people who just don't like lawyers out there, and I think they think we're necessary evils. They'd like to see us go away, but we can't. And there are just many reasons in my opinion, as to why we run into these types of things. We had a meeting, because we're trying to find people where we can find them, and I've always said I'll steal investigators or get help wherever I can get them to try to solve our problem. Last week we had all of our State regulatory agencies, they came into the office to see if we could tighten up and better stop these people from getting licensed, because it's much easier to stop them from being licensed than to license them and let them go out and commit their offenses under the criminal statutes, and then try to get the evidence to prosecute them under that.

And it was so frustrating just to sit there and listen. For instance, Robbie Robertson, who's got liquor, it's his job to go out and investigate these liquor licenses. He has two investigators in his office. Those two investigators cannot get out in the field, because they spend all their time answering the phone and taking the people who come to the desk. And we know there are bars right here in Phoenix and the State who are owned by organized-crime people. It's a good way to find out who they are if we can tighten up on our licensing procedure. If we can get more information on the application, if we can have people make further investigations on these people who are applying for licenses, we can deny the licensees from owning these bars and these restaurants in these areas.

But again, it all comes back to manpower, Senator. If you don't have the people, you can't get the job done.

And we foresee, and honestly we know. I just looked at a report here a couple of weeks ago naming names of people who are here from Buffalo, Cleveland, New Jersey, from Florida, from Denver, from Chicago, who are here. And we anticipate a much greater problem. We are a growing State, there's money to be made in Arizona, and that brings them into these areas.

Our new criminal code is an excellent criminal code. We are right now trying to tighten up in some areas so that we can make it a little

stronger, hopefully we'll get that done. But we have the RICO Statute in Arizona, same as the Federal Government has. We have used it, and the last time I checked, about seven times already in the last year.

We're trying to get onto it, but it's the same story. If you don't have the people, you can't get the job done.

Senator DeCONCINI. Do you see a growing trend of more organized-crime activities coming to Arizona from without the State?

Mr. CORBIN. Yes, sir, we do.

Senator DeCONCINI. What kind of an increase have you witnessed since you have been in office?

Mr. CORBIN. It's very difficult to say. I'm not sure when these people got here, that's my problem; they may have come 2 years, they may have come last year. We know they are here, and if we don't get onto this problem and don't try to solve it, we're going to have the same problem with organized crime we have with the land frauds.

You have got to get on them when they first arise, you have got to show these people if they're coming here they're going to be investigated and they're going to be prosecuted, and maybe they will stay out of our State if that's the situation.

Senator DeCONCINI. You were county attorney back in the mid-sixties. Have you attempted any comparisons between what you thought organized-crime involvement was then versus what it is today?

Mr. CORBIN. I think it's much worse today. In those days the land frauds were just starting, unfortunately we had the old Criminal Code which didn't have many statutes which covered these type of situations. We didn't have any grand juries—well, we had special grand juries—you recall that in Maricopa County the way we had to operate, we'd have to investigate a case then I would have to take the case to all the judges in Maricopa County at a luncheon and I would have to tell them what that case was about, and then they would tell me which case I could take to the grand jury. That is a very difficult way to operate, because these same judges may have to sit and try the case, and that bothered me quite a bit, but that was the only way I could get a grand jury.

Senator DeCONCINI. As attorney general you have a grand jury authority; right?

Mr. CORBIN. We have statewide grand jury powers, yes, sir.

Senator DeCONCINI. Is that actively being used?

Mr. CORBIN. Yes, sir, it is. Phil has got the figures on how many indictments and convictions we've obtained. We can have as many as three grand juries sitting statewide at one time.

Senator DeCONCINI. I want to thank you for having Mr. Shaefer down here. He was very helpful. He indicated that there is a great need for additional resources. He also left me with the distinct impression that the State was not going to fund it, at least hasn't so far, and indicated that there was a need for Federal assistance.

Can you give me any specifics on what kind of Federal assistance you think would be most advantageous to your efforts?

Mr. CORBIN. Senator, any assistance you can give to us at this particular point in time would be appreciated. I don't care whether it's a little or a lot; any would be appreciated. You need accountants in this

area, I don't have an accountant in my office—we have one I just hired last July to straighten the books out, but if we need an accountant to work in a criminal case of any type we have to go to the auditor general and borrow one of theirs if they have one free, and that's the only way we can have an accountant. You need specialists—not only accountants; you need trained investigators; you need attorneys trained in this area.

I am very pleased with the cooperation of the FBI. In fact, I just talked to them this morning and yesterday, too, on a matter on which both of our agencies found out we were involved in. We talked with them, and they're better equipped to handle it than we are, so we backed out. But when we get information, we relay it on to them, and we work with the FBI with the position that any case they are working if they find a State violation they will bring it to us, and they have done that in the past.

Senator DECONCINI. When they bring them to you, will they continue to work the case with you?

Mr. CORBIN. Normally they have concluded with it, and if we need further investigations on the State area, we do it ourselves.

Senator DECONCINI. Have you ever asked them to help you beyond the case, after it's brought to you?

Mr. CORBIN. No. I am sure you found when you were county attorney in Tucson that once law enforcement has delivered a case to you it's very difficult, because they're off on other things and they're all overworked. They just don't have the time, really, to get back and do it.

Senator DECONCINI. Would you agree, Bob, that it would be helpful if they would stay with you from the standpoint of a prosecutor?

Mr. CORBIN. Sure.

Senator DECONCINI. What is the percentage amount of your budget that goes toward the criminal division or special prosecution division?

Mr. CORBIN. In the criminal area Bill Shaefer heads up, there's about \$600,000, and in Phil's budget there's about \$600,000.

Senator DECONCINI. That's two different areas?

Mr. CORBIN. Yes; two different areas of the office.

Senator DECONCINI. Which one of those deals primarily with organized crime?

Mr. CORBIN. Phil's division would deal primarily with the organized crime area.

Senator DECONCINI. What percentage, Phil, is that of your total attorney general budget, or do you know?

Mr. McDONNELL. I believe, Senator, our full budget is about \$4.2 million.

Senator DECONCINI. So, it's about 20 percent or so?

Mr. McDONNELL. Yes.

Senator DECONCINI. And, Mr. Corbin, you have made requests—I know, I have seen them reported in the press—for additional assistance. Has that been primarily for organized crime?

Mr. CORBIN. Yes, sir. We have, and I might add, will be making additional requests for the organized crime area; that is what we're basically asking for.

Senator DECONCINI. What are you asking for? What does it amount to that you are asking for?

Mr. CORBIN. About \$2 million.

Senator DECONCINI. Would that be to augment Phil's effort, or to structure a new unit within your office?

Mr. CORBIN. What we would like to do, Senator, is to augment a new unit in the office. We have an individual we feel we can get at this particular time, who is well qualified to head up this investigative division to work with the regulatory agencies in trying to stop them getting in, and once they're in, to investigate them, to prosecute them after they're in—and ones who have already been licensed, we would need, of course, more attorneys. The attorneys we will be requesting will be not only for Phil's division but also in our financial fraud division which Pat Burphy heads up. They enforce RICO statutes civilly over in the financial fraud division of our office.

Senator DECONCINI. I wish you well in getting that amount of money. It seems to me if you are going to succeed, you must do it on a most sophisticated level, on the accounting level, and not just the street level of organized crime activities.

Mr. CORBIN. We do need investigators, but more than anything else in this area we need accountants.

Senator DECONCINI. Can you tell the committee in general terms, or can Mr. McDonnell, how many active organized crime cases you are involved in, so I can kind of get the idea of how extensive the problem is?

Mr. McDONNELL. Well, Senator, our division has been in existence for about 4 years now, and we have had a number of cases, but if you take the definition of organized crime, which I use, which is a broader definition than merely the mob, but organized criminal activity, we have had a dozen or more major organized crime cases that have been brought through indictment into trial, and several are pending trial now. Under investigation—we would have a couple of dozen cases under investigation.

Senator DECONCINI. Have you come across any cases involving bankruptcy schemes and bustout efforts?

Mr. McDONNELL. Yes, Senator. In the land fraud area particularly, and security fraud cases the bustout appears to be a necessary part of the scheme. One company, for example, that we haven't investigated but comes to my attention, is Hydroponics in the western area of metropolitan Phoenix; it seems typical. Where the individuals, potential investors, are sold a product, and the goods promised are not delivered, so they're ripped at that level, and then when the company goes into bankruptcy, the bankruptcy operation continues the ripoff. That's happened in numerous occasions in this town; in the land fraud area even more so than the security fraud area.

One prominent bankruptcy lawyer or trustee, I believe, was indicted recently by Federal authorities, so I think there has been a rather sad record in the bankruptcy court in Arizona.

So often the victims are twice victims. Just to follow up a bit on some of the attorney general's remarks, I think we take the broad picture there has been a good deal of progress. Five years ago, 10 years ago, there was no enforcement to speak of other than some Federal enforcement that limited manpower. There was no capacity at the county or State level; the statutes were written in 1901, 1910, for a simpler day, and the frauds were absolutely wide open in the land fraud area.

I occasionally will attend a conference or meet with my counterparts from other states, and they're amazed at the level of the ripoffs that were going on in the State; they're just wide open and blatant, and hundreds of millions of dollars were lost to tens of thousands of people.

There's been a great deal of progress since then. Our criminal code is now the best in the country, the most sophisticated. You have the State grand jury that is active, and attorney general's office that is active, several county attorney's offices that are active, and the police agencies have organized themselves significantly—Phoenix City Police, Tucson DPS, so there has been progress. But the one thing that I try to convince people on is the manpower commitment that is necessary.

Just for a single case—we tried the *Lincoln Thrift* case, it was a 17-week trial with four attorneys in trial, and when you add up that time plus the time and preparation, we estimate just in attorney time, not investigator time, it was 5.5 man-years on one case. On the combined equity land fraud that was 15 defendants, all were convicted; the Department of Public Safety committed an investigator for 3 years full time. We had approximately 2 man-years of attorney time on that case.

If you're going to do sophisticated cases, you're going to have to have commitment of the manpower, and that means money, and that means a willingness on the part of the political leadership to provide the money and then let the police and the prosecutors do their job.

And I think we have come all the way to the stage now where with an infusion of money and manpower we will see significant progress, very significant progress. We have the structure now, we have sophisticated police agencies and prosecution agencies, you have a sophisticated criminal code, and the mechanisms with the grand jury to make use of it.

Five years ago an infusion of cash probably would have been wasted, but not now. So however that comes about, through State, county, city or Federal involvement. I think it's welcome.

Senator, I think you could think about a Federal program of some kind which would be valuable. LEAA has been very instrumental in having us make some progress, and some of the police agencies, but to do white-collar and organized crime it has to be very much concentrated and it has to be a commitment of money for, I think, 3- to 5-year period before the results will show themselves to the local authorities, and they will pick up the people.

If you look around the country, Arizona now is one of the most progressive States in terms of sophisticated law enforcement. Some States, if you gave them cash, it wouldn't be used well, but Arizona, I think, would be used well. So I guess just to repeat what the attorney general said, and what others have said before, is that I think in view of the threat to the State, if we can have the commitment of the manpower and money, we will really make a difference, and I think we will be successful.

Senator DECONCINI. Thank you very much.

Mr. Corbin, in your experience, are you satisfied that the cooperation between Federal and State agencies in the law enforcement area is as great as it could be?

Mr. CORBIN. Senator, going back to days when I think both of us were county attorneys, there was very little cooperation among law

enforcement in those days between State, local, and Federal authorities. I have seen a total change in the thinking between local law enforcement and Federal law enforcement, which I think is excellent. It is like all governmental agencies in this particular area, there will always be, and perhaps it is good, a little jealousy of who is going to make the case, who is going to make the bust, who is going to get it for the publicity purposes, for their budget purposes, to show that they're doing the job. It creates competition between the agencies which I think is good, if it makes them more effective.

I don't know how you would ever change that so that there can be no competition between them, but in answer to your question, I think that there is an awful lot of cooperation today that we did not have in the past; there could always be better cooperation.

Senator DECONCINI. Is there any vehicle to improve that cooperation?

Mr. CORBIN. I think the different individuals involved in the area—I know we meet with Mike Hawkins quite often, and I know some of the FBI people, but have never gone in and just absolutely sat down with them and say, "hey, how can we cooperate." I think things which I have done with the county attorneys and sheriffs and DPS, I think that, and that would be up to all of us heading the various agencies, to sit down together, and if we have problems, work them out, and how we can assist each other. I think we'd better start doing more of this, because I think with the economy the way it is and people pretty well fed up with their taxes, it's going to be very difficult to convince city councils, boards of supervisors, and legislators in my instance, that there should be more money put into law enforcement for these particular areas.

I think we're going to have to cooperate a lot more in the future, not duplicate efforts in various cases, and not be jealous of who handles them, and just as long as we get the job done, because I think that's what we're all here to do.

Senator DECONCINI. Is it your experience or Mr. McDonnell's, that when the prosecutor is involved in the early stages of investigation that the cooperative effort is greater?

Mr. CORBIN. Oh, yes. We believe in our office, and when cases initially come in for investigations, we have attorneys assigned to it at all times.

Senator DECONCINI. Who stays with the case?

Mr. CORBIN. Right, who stays with it all the way through from the very beginning.

Senator DECONCINI. And then he or she is liable to know what other agencies may be doing with it, too?

Mr. CORBIN. Sometimes there is a breakdown in communications between the agencies, that happens, that's human nature.

Senator DECONCINI. Mr. McDonnell, is your division involved in extensive arson investigation? Can you tell us anything about that problem here?

Mr. McDONNELL. We have not done too many. We have done a couple of arson matters when requested by county attorneys. Our jurisdiction comes through the State grand jury, which is crime more in the white-collar area. We would need expanded jurisdiction to get into that area. We have acted, though, in a few matters we have learned something from those cases. There is a growing arson prob-

lem, and especially in the metropolitan areas. Arson for insurance profit seems to be a primary activity. In order to meet that problem, what we see is a need for increased sophistication in the various prosecution and police and fire agencies, and some have achieved that, mainly in Phoenix and Tucson. The other areas are lagging; there's a lack of experienced people and a lack of equipment. That's a real specialty case, and you really have to build up the expertise. So what we have urged is that the State fire marshal's office take an active role in aiding those communities that need the help, and have a quick response unit to go out and do the investigation when requested, and have an attorney available to come and assist the county when requested. I think arson will remain a primarily local crime, because it will be initiated—the investigation will be initiated by the firemen at the scene, calling the policemen at the scene, looking at the evidence at that time and determining whether it might be an arson or not. So that's what we are urging: is to beef up some State assistance to assist local people in that.

Senator DECONCINI. Do you have any information that would lead you to believe that organized crime is involved in arson in the Arizona metropolitan areas?

Mr. CORBIN. Senator, I have a very good friend who is in the Federal agency. He is an investigator, and he was telling me a story that, yes, organized crime is involved. In fact, he told me where to call if you wanted something burned in another State.

Senator DECONCINI. So it's pretty sophisticated and widespread?

Mr. CORBIN. Yes, sir.

Senator DECONCINI. Thank you. I have no further questions. I want to thank you and Mr. McDonnell very much for being with us.

Mr. CORBIN. Thank you very much, Senator, for having us, we appreciate it.

Senator DECONCINI. Our next witness will be Michael Hawkins, the U.S. attorney.

Mr. Hawkins, thank you for being with us today. If you would please proceed.

#### STATEMENT OF MICHAEL HAWKINS, U.S. ATTORNEY

Mr. HAWKINS. Thank you, Senator. An old and good friend of mine who was county attorney at one time told me of the dangers of being personally involved in litigation in terms of managing an office. I have prepared remarks, they are being typed at this point, because the last 2 days I have been involved in interlocutory appeal to the ninth circuit involving prosecution in the southern part of the State that I think you're familiar with. But it's a pleasure to be here this morning before you, and I want to thank my boss, Benjamin Civiletti for allowing me to be here today and being confident enough in what I would say in response to your questions to let me come in here freelance and let me talk about the significant problems. I'll not go into great detail about what those prepared remarks would be.

There are one or two comments in terms of overview and substance that I think are very important here. There is a fairly common notion of good in this country, and that organized crime is sort of a Robin

Hood-like fraternity of people who only hurt each other and do no violence to other people other than those that voluntarily consent in their illicit activities. That's hogwash. Organized crime is with us today, it's as near as the local bookmaker, it's as close as the "line" that's published on college football games in our local newspapers, and it's as real as the execution murder of Ed Lazar. It's with us every day. It has direct impact that the National Chamber of Commerce says the impact is on the order of \$30 billion dollars a year.

I sat in on a think-tank seminar about a year and a half ago with a vice president of the International Garment Workers Union, who is writing a book called "The Hidden Economy." He estimates the impact of organized crime to be 10 percent of the gross national product, or a staggering \$300 billion per year. Whether \$30 billion is correct or \$3 billion or \$300 billion is correct, the cost is enormous.

It also has significant indirect impact: The cost of goods, meat is higher when the price is fixed when there are kickbacks to drivers and producers; it has indirect effects on the efficiency of services when companies and unions are being threatened by people, or extorted by people involved in organized crime; it effects the efficiency of those services. There is a loss of tax revenue, again, whichever figure is accurate, about the illicit and illegal income of organized crime. The Nation is being deprived of a substantial revenue source by it not being reported, and in all the evidence that I have seen to date, a great bulk of it is not being reported, although, for reasons that you well know, there is no reason why organized crime should have any fear about reporting every penny of their legal income, thanks to the overzealousness, I think, on the part of some legislators earlier, a defect that you have tried to remedy recently, and I urge you on to further efforts in the future.

The most dramatic effect, I would suggest of organized crime, is its systemic impact and the impact that it has on the confidence of the average citizen and the ability of Government to deal fairly and even handily with a terribly difficult problem. And it's as basic as a kid on the street preparing to steal a car, who has the somehow twisted justification that the big boys do things and get away with it, therefore, I can do it. And that's real, and it happens every day. Unless we do something about it, we face a dramatic loss in the confidence of the public and the ability of law enforcement and even Government to deal with this problem.

We spend a lot of time—I heard some of the earlier speakers talk about definitional problems: what is organized crime. In the view of many, myself included, we have spent far too much time trying to define it. We have been embroiled, for example, in discussions about its ethnic background, a definition I think everyone of us should condemn, and I think it's a mark that as we talk here today, the Attorney General of the United States, the chairman of the committee I am now speaking to, and my right arm in organized crime efforts in Arizona, Paul Corradini, are all distinguished Americans of Italian descent, and I think we ought to condemn that sole and exclusive basis for defining—can't be defined either, I think, by geographical limitations or fictional stories of what has occurred in the past. I think we ought to move on and deal with it.

To organized crime in reality is—it is really in two forms: Traditional organized crime, which Gene Ehmann did a remarkable and commendable job describing to you earlier, and I won't go back over it, and what I call nontraditional organized crime, organized, sophisticated, financially fit, well-advised people who are active in businesses that are distinguished by several characteristics. One, the ease of entry into the business; two, it's low overhead; three, the lack of prominent, strong regulatory effort locally, and the "attitude of public approval," such as in the area of sport gambling—soft or hard public corruption and apathy.

I am reminded of the story of the president of the local civic organization who saw a friend of his on the street and was congratulated about being elected president. He said, "What are you going to do in this organization?" He said, "I'm going to fight two things: ignorance and apathy." He said, "What do you think about that?" And the response was, "I don't know, and I don't care." That is a prevalent attitude among local regulators and funding agencies.

Interestingly enough and for people who are students of that subject, and I know you are, Senator, Arizona history plays some part in this for good and proper reasons. The people of Arizona have for the past distrusted Federal intervention into the State, they have preferred a wide-open attitude, an entrepreneurial attitude toward new business and new business opportunity, an open-arms attitude toward growth, and a real disdain on a bipartisan basis for overregulation on the part of the State and Federal Government.

Well, as all pendulums go, that pendulum was at the wrong location, it's swinging back, thankfully, now, but we now pay the price for that lack of early regulation. General Corbin is absolutely correct when he notes that the costs, the enforcement costs of stopping this activity at the licensing stage are much insignificantly less than they would be at the enforcement stage, and I just ponder at the thought if Ned Warren, Sr., had been denied his real estate license by the State real estate commissioner at the time that he first came into the State, what the ultimate effect would have been. And General Corbin could not be more correct about that very point.

We have made efforts nationally and locally in the area of traditional organized crime prosecution: The Licavoli and Walker prosecutions in Tucson; the Battaglia prosecutions which brought on their heels the Cammato's and Catalanotto's prosecution in the southern part of the State; the pending indictment against Joseph Sarafaute; the Joel Hauser indictment involved in the \$5.5 million ripoff of the labor insurance premium payments, which is prosecuted under the RICO Statutes, and the Bonanno prosecution in which the Arizona Drug Control District, the FBI, and our office cooperated with the strike force out of San Francisco, is pending and awaiting trial in San Jose, Calif., later this month.

There are disturbing trends about investigations that I can't comment on in great detail; they have been talked about here today. The two most dramatic are the infusion of organized crime money, traditional and nontraditional organized crime money into legitimate business. It becomes increasingly difficult on a personal note for those of us in law enforcement to know which restaurant to go to, to know which

movie theater is OK to go to, to know which person to associate with on the street or to say hello to on the street, and it's true because the ease of business entry in Arizona is, it relates and is analogous and pours over to the area of the ease of social and political entry in both parties, and in all social strata in the State. If you have been especially here in the Maricopa County area for 3 or 4 years, you're considered a native. Now to the folks in Tucson, and I suspect to the folks in Winslow, and Flagstaff and Kingman, that would seem preposterous. But I remember folks saying that my grandmother hadn't been around here too long, and she was only born here in 1880. But it's so transient, the population growth has been so great that both the victims and perpetrators alike can't make any realistic assumptions about ties to the community.

It has an interesting impact on sophisticated white-collar crime in Phoenix, vis-a-vis Tucson. Tucson is still a community with close, tight knits; people who have been there a good deal of time. And when there's new business entry into that community, people know about it. If there are large-scale efforts to market securities, sell land, open franchises, people there know about it, and they can tell if they're an outsider and whether questions ought to be asked in other locations. That's not true here. And we have as a result, I think, a more dramatic effect in this area, in the Phoenix area. Our resources are pledged to it. The one question I have heard you ask before is: How much money is needed, and what kind of money is needed?

I'm not sure, to be perfectly honest and fair and consistent with the President's attitudes toward the budget, particularly in nondefense areas, and I share that attitude as a member of his administration, that that is necessary.

I think fine tuning can be done. I think we need to examine priorities. I think we need to look at the cases that we've prosecuted in the past, particularly those crimes that can be prosecuted either in State or Federal court and make hard decisions about where they ought to go. Simply because someone robs a bank in downtown Phoenix and steals \$1 million doesn't mean that has to go to Federal court. It can go to State court, and in fact under the new State Criminal Code can probably be prosecuted more effectively there than in Federal court. We have been involved in a significant program over the last 2 years to do just that, to shift a lot of these concurrent jurisdiction cases back to the State where they belong, so that we in the Federal system can concentrate on those criminal activities that really do affect Federal interest; that cross State lines, that impact the instrumentality of interstate commerce, and that really involve national Federal programs, such as the infusion of Federal funds.

I will be happy to answer your questions.

Senator DECONCINI. Mr. Hawkins, thank you very much. Let me express the appreciation of this Senator, and the other members of the subcommittee, for your leadership and the staff that you've put together. You certainly have directed the U.S. attorney's office in a proficient and meaningful way in Arizona.

And let me ask some questions. If you can, without revealing, obviously, the intrigue or the delicate parts of the investigations, has your office been actively involved, and are they actively involved in bank-

ruptcy bustout schemes which could be termed organized, and, if so, what is the extent of that problem in the valley or in Arizona?

Mr. HAWKINS. It's a substantial problem, Senator. The publicity, however, from a prosecution that is complete, but on appeal, and for that reason I can't go into great detail about it except to comment that all the individuals were convicted and given time and custody of the attorney general in prison. The publicity, in fact to that, has been substantial. Up to that point that was a significant problem. Individuals coming into the State, ease of business entry again, buying a lot of equipment, consumer goods, that sort of thing or credit, and then just taking it out of the State—clearly planned, clearly organized, high profit, and a lot of creditors are left holding the bag.

The bankruptcy system, as you well know, is a complex system, and it affects dramatic and different interests, and it is frequently the graveyard of a lot of business opportunities, legitimate ones as well as illegitimate ones. My sense of the situation here, nationally, is that in the vast majority of the cases the bankruptcy laws are ministered fairly and competently. There are problems; there are problems everywhere.

We have had particular problems in Arizona with trustees, receivers, and some other personnel from outside the court system appointed by the court system. It's a little difficult to tell, as Jack Smythe noted, the precise impact of the new Bankruptcy Act, but some points in that act that I know your subcommittee was responsible for are enlightening, they're bright, they're good ideas. The early evidence is that they're working. Those are the things, such as the separation of bankruptcy judges on the day-to-day administration of the States; the appointment of the U.S. trustees under the Justice Department and a few test districts; the creation, which I think was long over due, of a priority for the creditors who are the provable victims of consumer fraud, and a simpler way of handling no-asset cases are good things. They're working because they are good things, and we're very happy to have them.

Senator DECONCINI. Mike, you mentioned the case that's on appeal that you can't go into, and I understand. Did I gather that because of the publicity you feel it's had a positive effect resulting in fewer bankruptcy schemes?

Mr. HAWKINS. I think we have less on the specific subject of bustouts.

Senator DECONCINI. Because of that?

Mr. HAWKINS. We have less of problem with that, perhaps because we have more alert creditors and the trade association and insurance associations, and never—no one should ever underestimate the impact that the private sector can have in all of these law enforcement areas. The insurance industry, for example, has been a phenomenal help to us in a number of areas, this included, in educating the people that they insure about the potential for problems and what the indicia are of companies that are formed for this purpose.

Senator DECONCINI. So, obviously strong prosecution has raised awareness in the whole community.

Mr. HAWKINS. I don't think there is any question about it. Anytime we've had an indictment or prosecution in a new subject area, and

3 or 4 years ago bankruptcy bustout schemes were a new subject area for most people, when they're written about in the print media, covered in the electronic media, we get a discernible response from the citizenry: Hey, let me tell you about this case. All right, I saw an article in the paper. Let me tell you about this situation. We have a bankruptcy case now red hot for investigation in Tucson as a result of a newspaper article in the existence of County Attorney Steve Neely's hotline for fraud down there, where somebody called in and said: I know someone that petitioned for bankruptcy, and I know where they have lots of money, and here is where it is. That sort of thing. Citizen participation is absolutely essential.

Senator DECONCINI. What about land fraud? Is the State of Arizona witnessing any lessening in the amount of bankruptcy, land fraud schemes and sales?

Mr. HAWKINS. Senator, we have some investigations. I think it's fair to state we have reached sort of the back of the file cabinet. The golden age of land fraud is, I think, Al Sitter has called it before, is over, thankfully, but we as a State and the citizens of this State will pay a price for a long, long, long time to come because of the ripple effects of that bankruptcy, and some of them, I think, people did not even perceive.

Failure, for example, of fraudulent developers to adequately grade and prepare and set for ready subdivision development when the floods come, those are the first people hurt. The failure of them and the title companies, and the like, to accurately check and deal with the paperwork that effected their title will continue to plague people who thought they were investing in a place that they were going to retire in for a long time.

So the spillover affects not necessarily in the criminal arena, but just as importantly, in the private lives of our citizens. It's going to be felt for a long, long time to come.

Senator DECONCINI. Thank you, Mr. Hawkins, very much. We appreciate your testimony.

Mr. HAWKINS. Senator, if I can say one thing before I leave; I always make it the last thing. My father once told me that a good leader takes a little bit more than his share of the blame and a little bit less than his full share of the credit. The work that's done in the Federal system through our office in Arizona is done by the assistant U.S. attorneys, the career people in my office, and by the many fine investigators that we have, especially from the FBI, and we couldn't do it. I am just sort of the spokesman. We sure appreciate the support of the Congress.

Mr. DECONCINI. I understand. I was there once myself. Thank you. [The prepared statement of Mr. Hawkins follows:]

PREPARED STATEMENT OF MICHAEL D. HAWKINS

INTRODUCTION

Mr. Chairman: I want to thank you, Senator, Senator Kennedy, and my boss, Attorney General Benjamin R. Civiletti, for the opportunity to be here this morning and share some thoughts on two subject areas of real and pressing concern: organized crime in Arizona and the bankruptcy system here. As my remarks will hopefully show further on, the two subjects are sometimes related and sometimes not.

With me here this morning is Paul R. Corradini, our organized crime specialist in Arizona, who is an attorney with the Organized Crime and Racketeering Section of the Department of Justice, and who is part of our operations here in Arizona. Paul does the bulk of the organized-crime work and we are very proud of him. In fact, we intend to ask the Department to "clone" him so that we can double our efforts.

A prefatory comment: My remarks here today represent my own views and not necessarily those of the Department of Justice. In saying that, I do not mean to disassociate myself from the Department for I am very much a part of it. I guess it's just a formal way of saying that if I misstate anything or offend anyone blame it on me and not on them.

My remarks will touch on past accomplishments, lightly and briefly on work in progress, and some thoughts about the future. The accomplishments are not mine. They are those of the many fine investigative agencies that serve the United States, especially the Federal Bureau of Investigation and the hard working assistant U.S. attorneys that serve the cause of Federal justice here in Arizona. My father once told me that a good leader takes a little more than his fair share of the blame and a little less than his fair share of the credit.

#### THE PROBLEM: AN OVERVIEW

There is a common notion afoot that organized crime is a Robin Hood-like fraternity of folks who really only hurt each other and do no real harm to people who are not willing participants in their varied activities.

The fact, of course, is that organized crime pervades our everyday lives. It is as near as the neighborhood bookmaker, as open as the "line" on college football games and local newspapers, and as real as the execution murder of Ed Lazar.

Organized crime is by its nature clandestine and conspiratorial. As a result, it is enormously difficult to state with any precision what its real impact is. The American Chamber of Commerce has estimated its economic impact to be \$30 billion per year. Others have privately suggested that its full impact may be as high as 10 percent of the gross national product or a staggering \$300 billion per year.

Less direct, but just as real, are the effects of organized crime on:

(1) The cost of goods as the result of price fixing, bid rigging, kickbacks, and payoffs.

(2) The efficiency of services—companies or unions that are victims of threats, extortion, and outright theft are demonstrably less efficient as a result.

(3) Loss of tax revenue—because organized crime draws its profit from activities that are largely illegal, it is not, you can be sure, reporting its largess of illicit profits. The impact on all taxpayers is more than just speculative: while we cannot be sure that what they don't pay the law abiding citizenry must make up, the absence of tax revenues on the enormous profits of organized crime, whether those profits be \$3, \$30, or \$300 billion, is very real.

Just as important as the direct and indirect effects of organized crime is the impact that it has on the public perception of the ability of law enforcement to deal effectively and evenhandedly with the problem. There will always be those cynics among us who believe incorrectly, I think, that the criminal justice deals sternly only with "street" crime and much less effectively with economic and organized crime. Real or not, these perceptions may affect the fabric of general citizen compliance, which is at the heart of the process of effective law enforcement in an open democracy which cherishes constitutional rights and liberties. To the young man, in a poor section of town, poised to steal his first car, the feeling that it's "okay because the big guys get away with the big stuff" offers a twisted justification for what he is about to do. We must attack that perception by our performance and I know to a personal certainty, Mr. Chairman, that this attorney general is committed to do that.

#### DEFINITIONAL PROBLEMS

Far too much time and effort has, in the view of many, been spent trying to define just what organized crime is. Definitions based on ethnic backgrounds (which we all should condemn), geographic origin, or the fictionalized stories of the past are not only not productive, they distract from the real goal: dealing forthrightly and effectively with the problem. Like obscenity, however, to para-

phrase Justice Stewart, we may not be able to define it, but we know it when we see it.

Without becoming embroiled in definitional debates, we can make some observations about organized crime's characteristics or indicia:

- (1) Tight-knit conspiratorial operation and organization,
- (2) Rigid of enforcement of internal discipline, and
- (3) Entry into activities that are themselves characterized by: (a) Ease of entry economically, socially, and practically; (b) low overhead high potential for profit, and (c) lack of regulatory activity which may be brought about by: (i) lack of knowledge, concern; (ii) public "approval" (sports gambling, etc.); (iii) "soft" or "hard" public corruption.

#### WHAT IS BEING DONE

Nationally, I share Attorney General Civiletti's view that real and substantial progress, the result of careful thorough work by investigators and prosecutors, is being made on the organized crime problem nationally. These accomplishments include:

(1) Conviction of 66 labor officials and shipping executives in Miami and other Atlantic and Gulf Coast ports on charges of extortion, kickbacks, and income tax evasion.

(2) Anthony Provenzano, the president of the largest teamster local in the United States, and three of his associates have been convicted of extorting approximately \$1 million from a major steamship company. Provenzano was sentenced to the maximum term he could receive of 20 years in prison and denied bail pending appeal.

(3) Howard T. Winter and several top associates have been convicted of obtaining millions of dollars through bribery, violence, and intimidation in the fixing of more than 200 horse races around the country.

(4) Frank Ammirato, considered one of the strongest organized crime leaders in south Florida, has been convicted of manufacturing illegal firearms and importing illicit narcotics.

(5) Vincent Meli has been convicted of trying to corner the steel shipping market in Detroit by intimidating drivers into waiving contractual benefits.

(6) George Boylan, a New York labor leader, has been convicted of extorting more than \$1 million from construction companies building power plants.

(7) Anthony Scotto, a vice-president of the International Longshoreman's Association and president of a powerful New York local, has been convicted on charges of labor racketeering and income tax evasion. This case, I should note with some fraternal pride, was personally prosecuted by my fellow U.S. Attorney Robert Fisk, Jr. in the Southern District of New York.

These are, in my view, substantial and significant achievements and Phillip B. Heymann, head of the Justice Department's Criminal Division and David Margolis, head of the Organized Crime and Racketeering Section, and the many fine FBI agents and prosecutors working for them, deserve full credit.

Locally, we have been very active in the area of "traditional" organized crime prosecutions. Our activities in the last three years include:

(1) Peter Licavoli, Sr., convicted of receiving stolen property (a valuable painting); conviction affirmed by the Ninth Circuit Court of Appeals in the face of contentions of illegal electronic eavesdropping.

(a) Ronald W. Walker, Jr., a Licavoli associate, convicted of perjury in connection with the above investigation.

(2) Charles B. "Batts" Battaglia, convicted in 1978 for his part in a fraud scheme concerning the submission of false claims to an insurance company on a "stolen" car.

(a) Gregory "the Greek" Kommatos, arrested and indicted in the same activity. Kommatos was convicted on conspiring to distribute heroin. Although a three-judge panel of the Ninth Circuit Court of Appeals reversed this conviction, we have petitioned the full 23 judge panel of the Ninth Circuit to hear the case. That petition is pending.

(3) Joseph Cefaratti, indicted in September 1979, on tax evasion. The indictment alleges that from 1972 through 1974 he reported a total of \$9,000 in income when, it is alleged, his actual income was \$1.5 million.

(4) Joel Hauser, national RICO conspiracy to steal/embezzle \$5.5 million in labor union insurance premium payments. Convicted, pursuant to his plea, of violating Federal racketeering statutes.

(5) Joseph Bonanno, indicted in the Northern District of California for conspiracy to obstruct a grand jury investigation. Major events of this alleged conspiracy are claimed to have occurred in Tucson, Ariz. The indictment here was the result of substantial Federal-State law enforcement cooperation. Trial is presently scheduled for February 13, 1980, in San Jose, Calif.

More exciting, and with even more potential, are a number of matters presently under investigation about which I cannot comment except to note, in the most general of terms, some perceived trends:

(1) *Legitimate business.* Evidence is beginning to develop that there is a substantial effort in Arizona to infuse out-of-State money into local legitimate businesses.

(2) *New entry.* Suggestions of new eastern seaboard organized crime elements moving here, not simply to retire, but to "set up shop" and conduct business as usual in such areas as: illegal gambling, bookkeeping, loansharking, sports bribery, arson, and car theft.

#### NONTRADITIONAL ORGANIZED CRIME

All of the above, with some ease, can be categorized as traditional organized crime. In other words it could comfortably fit within most standard definitions of it.

Just as organized, effective, and dangerous is a "new" breed of organized criminals. Sophisticated, well-bred, and educated, but just as calculating and every bit as dangerous. Some would say more so, because these folks are best characterized by what we do not know about them.

They fall, we believe, into several categories:

(1) *Fraud men.*—Land fraud yesterday, precious metal, stone, or energy fraud today; these types thrive in an atmosphere of underregulations, poorly financed local law enforcement, and public apathy. They are especially prevalent in places, like Arizona, where the population is so transient and recent growth has been so dramatic. Arizona is not alone in feeling their impact; the entire Sunbelt has felt their effect.

(2) *Narcotics conspiracies.*—Dealing in heroin, cocaine, and South American marijuana today; using ships instead of airplanes and shipping tons instead of pounds, these groups are strong, powerful, and arrogant; witness the recent assassination of U.S. District Judge John Woods, in Texas.

(3) *"Freelance" operators.*—Operating in the gray area between traditional and nontraditional organized crime, these folks are the modern-day "hired guns." They burn, explode, and kill, all on request and for handsome fees.

(4) *Gangs.*—Operating in and out of prison, on and off motorcycles, these groups have all the indicia of traditional organized-crime families. They are carefully organized, have rigidly enforced discipline, and a carefully tuned eye for high-profit illicit businesses.

#### BANKRUPTCY

It is critically important to note here that the bankruptcy laws are administered, day in and day out, without incident and with fairness and overwhelming majority of the time. Like corrupt public officials, however, it takes precious few questionable incidents to spoil the public's perception of the entire system.

It is important to understand also that bankruptcy is, in a very real sense, the graveyard of entrepreneurial activity. With the failures of honest individuals and businessmen come the skeletons of the schemes of both traditional and nontraditional organized criminals.

Attached is a recap of major Federal criminal cases in Arizona in the past 2 years, to date, that arose from bankruptcy matters. The information speaks for itself. It is important to note here, as a matter of summary, that the major fraud cases on that list alone involve 30,000 victims and more than \$70 million in investor loss.

It is far too early to comment on the effect of the recent reforms in the Nation's bankruptcy laws. They went into effect, as the Chair well knows, in October of 1979. Accordingly, it is difficult to give any firm assessment of their impact. There are good signs, however, and the most dramatic steps taken in the act offer the most hope:

(1) The separation of the judicial role of U.S. bankruptcy Judges from the day-to-day administration of bankruptcy estates, and in several trial districts,

the creation of U.S. Trustees, who are part of the Department of Justice and oversee the appointment of receivers, trustees, and related personnel.

(2) The creation of a priority for creditors who are the provable victims of consumer fraud.

(3) The simpler handling of cases that clearly involve no assets.

#### CONCLUSION

Thank you, Mr. Chairman, for the opportunity to be here today. Your efforts in the support of the Department's efforts in the organized crime field and the reform of the nation's bankruptcy laws are deeply appreciated, I believe, by Attorney General Civiletti and all of us who work for him. I will be happy to answer your questions.

Attachment.

#### BANKRUPTCY-RELATED MAJOR CRIMINAL CASES (1977-79), ARIZONA

##### MAJOR FRAUD

##### Cochise College Park:

Amount of loss—\$28 million.

Number of victims—16,000.

Subjects indicted—19 individuals, 5 companies.

Subjects convicted—16 individuals, 4 companies.

##### Consolidated Mortgage Corporation:

Amount of loss—\$18 million.

Number of victims—5,350.

##### Del Rio Springs:

Amount of loss—\$7 million.

Number of victims—3,000.

##### Lake Havasu Estates:

Amount of loss—\$5 million.

Number of victims—2,500.

##### New Life Trust:

Amount of loss—\$7.5 million.

Number of victims—2,500.

##### Thunderbird Valley:

Amount of loss—\$5 million.

Number of victims—1,500.

##### TRUSTEES, RECEIVERS

James B. Burrus—convicted; Chas. R. Johnston—indicted, Antg. trial; and eight others under investigation.

##### CLAIMANTS

Thos. B. Manchester—convicted; Theodore A. Thomas—convicted; and four others under investigation.

##### SCHEMES

Video Flex (Peres, Siefert, et al.)—convicted; Western Car Care (Roland Ellis Parker)—convicted.

The next witness will be Frank Murray, chief, special operations bureau, Maricopa County Attorney's Office.

Mr. Murray, we welcome you here. Please proceed.

#### STATEMENT OF FRANK MURRAY, CHIEF, SPECIAL OPERATIONS BUREAU, MARICOPA COUNTY ATTORNEY'S OFFICE

Mr. MURRAY. Thank you, Senator. I might say that it's not my notion of anybody's ideal lunch that they should spend it listening to me, so I am going to do my best to keep my remarks as brief as possible. I probably ought to, however, spend a moment describing what I am not, that may be as important in the context of these hearings as what I can tell the committee.

I am not a Federal official and as such, I do not have the kind of detailed knowledge about powers to order payment, bankruptcy investigators, and the efficacy of having them, keeping a centralized record system or reform through fiddling around with time periods in connection with how often someone can declare bankruptcy or how long his dischargeable debt period ought to stay open. I can't give you any practical advice about that; that's not in my jurisdiction.

I am the head of what is, in essence, a racket bureau for the local DA, and in that connection I can tell you some things that relate directly to bankruptcy matters and pertain to possible legislative reform, I can tell you of some matters from direct knowledge concerning organized crime and its activities in connection with those.

In that vein we have current active knowledge in the form of an investigation presently underway that there are, in essence, walk-aways or bustout operations, as they're referred to frequently by police and law enforcement personnel, that involve connections directly to organized crime, casual and business connections.

We have one individual currently under investigation who has ties to no less than six distinct organized crime families, he is a prolific practitioner of his work, which includes all of the classic characteristics of bustout artistry. He lists his occupation, as is typical in this field, as that of a business consultant, a man to which you would go to receive advice in successfully running your business; yet his background is a carnage to disrupted corporations and wrecked business ventures. He is currently under investigation in connection with dealings in Arizona involving at least 30 to 40 corporations. The work is extremely complex and involves voluminous corporate records.

And if I may note a parenthetical note at this point, I would agree entirely with Attorney General Bob Corbin in stating that probably the biggest obstacle that we're facing right now is accounting expertise. Even recently when we received funding for an accountant, the particular kind of accounting expertise that is needed demands an individual who has a highly specialized knowledge of a very difficult skill, and that is a fraud audit. These people are hard to find and demand high salaries well off the scale, typically, of normal-type of an intransigent accountant applicant to a law enforcement agency, and over and above that, are useless to us unless they can support and substantiate their view in court as an expert, and need the credentials to be able to do that.

Ned Warren, whose prosecution our agency is responsible for, was, in essence, if you had to describe him truthfully, a bust-out specialist. He had all the traits of a bust-out specialist, that's what he did. He complemented that with a large development of a cadre of corrupt officials to aid him in that capacity, that included all of the typical money drains that are practiced by bust-out artists: selling of worthless assets for Cadillac prices, the poorly secured loans between corporations, the creation of a corporate maze and the basic piling up of a debt structure, which subsequently leaves the corporation without assets to secure it and, in essence, operates to the defraud of creditors.

I would note at this point in time one very mild and narrowed dissent to the remarks of Mr. Hawkins, and that really leads into my next point.

I disagree whether or not the denial of a real estate license by regulatory agency would have done any good in the case of Ned Warren who operated in Arizona for 4 years without benefit of a real estate license at all. And that does lead to the next point I wanted to make. The man locally does have, did have, organized crime connections. In any kind of a case that he operated in, in any kind of a large bust-out operation that was performed by him, he had people who were not only licensed to sell real estate but in the case, for example, of Combined Equity, for which we convicted him, were licensed to broker the sale of real estate by the State.

And when such people can be obtained, it once again points back to the licensing structure. However, it shows that Warren was able through the use of his organized connections and his power to organize individuals to commit crimes, to avoid that regulatory structure. Something more is needed.

Phoenix, as much, and as it is regarded by organized crime, is considered an open city. It is similar to Las Vegas in that respect. We have representatives of many, in fact, virtually all crime families present in Phoenix, and Phoenix more importantly—

Senator DECONCINI. Mr. Murray, let me interrupt you there. You say Phoenix is an open city, but that you have evidence from outside the State of Arizona that it is a growing target for organized crime. Have you obtained that information from wiretaps?

Mr. MURRAY. I think we have better than that, Senator. We have evidence directly from the lips of those involved, gathered through covert means, that it is regarded as an open city.

Senator DECONCINI. And that Phoenix is targeted for more crime growth?

Mr. MURRAY. That reputation and remarks that I am thinking of in answering your question is fairly recent. The reputation as evidenced by the easy level of cooperation of these individuals is further corroborated by that fact. We see people come in, there doesn't seem to be any kind of contesting or jurisdiction. Many cities have a geographical distinction of jurisdictions on the part of different organized crime groups within them. Phoenix has never evidenced any sort of geographical territory.

Senator DECONCINI. Thank you.

Mr. MURRAY. The same things that make us attractive to different industries, makes us attractive to this industry. I'm not an expert on the effects or the consequences of right to work laws, but I understand generally that the reason that we have Digital and Honeywell and Motorola, and other such electronic component parts industries is because our laws favor their kind of work. We have right to work laws that are a form of favorable climate for them to settle in, and it is no different for organized crime.

The laissez-faire tradition of Arizona, as referred to by Mr. Hawkins, is very much operative here. There is a need, therefore, for something more, something more than law enforcement to combat this problem, and that's what I wanted to highlight today. That's what I wanted to mention.

I'm concerned that organized crime in the process of making what is, in essence, a business decision to relocate, is going to do that on the

basis of what they see and continue to see as a soft attitude in Phoenix, and that is the problem we face here.

Set in the context of one particular organized-crime traditional industry, if you will, this problem is easily observed in connection with gambling. The typical gambling operation of a big city is not present in Phoenix. We don't have numbers here, we don't run policy, but when the "Sun Devils" take the field on Saturday afternoon or evening, or when the "Suns" take the basketball court, Phoenicians, as they do all across the Nation, come out and they operate sports betting and they practice it in the valley in connection with bookies who operate here.

In connection with sports betting operations there is in Phoenix, as well as there is elsewhere, a great deal of favoritism toward the local teams, that leads to disbalanced books, and the bookie who is in the business of taking a percentage of each losing bet that's placed with him, can't afford to suffer a bath if he has a huge amount of bets on the Phoenix side of the ledger as opposed to another basketball team. So he has to pick up the phone and he has to call out of State, and he has to find someone else to deal with to place what's called a lay-off wager. In connection with placing that wager, as someone who's prosecuted several gambling cases involving many, many people in this jurisdiction, I can tell you that he will talk to a man that he does not know, he will call him a name which is not his name, and he will be referred to in code fashion by a name that is not his, and these people would not know each other if they passed each other on the street. But come Monday or Wednesday when it's collection or payment time to all of the bettors who place their bets, and whether Arizona or Phoenix has won or lost, he'll have the money there to pay off his bettors. And if he's placed the bet to cover himself and the other team beats the point spread, he'd better pay off that layoff bet that he placed outside the jurisdiction.

The thing that makes that system run so perfectly and so well is not the Federal Reserve Board, for organized crime operated in that respect to local gambling, but there are characteristics of gambling outside the State that are beginning to be observed in the Valley, and this is what is disturbing, this is the kind of influx that's disturbing.

Sports fixing, for example, big room operations with bookkeepers and runners and clerks, people who receive bets, cheeseboxes and other electronic gear to deflect calls, and in connection with that, official corruption to protect it. We can't be proud of the record of our own public officials locally as noted by the IRE reports. Arizona public officials distinguish themselves according to their investigation for how cheaply and how readily they sold out.

In connection with Eastern-style influences on an industry like gambling, the influx could reflect itself in a different criminal practice than we have locally in the valley. The problem the prosecutor has highlighted in all this, is illustrated by the slowness of what is, in essence, a reactive mechanism. It takes, and I'm being generous here, a year or so to detect many of these kinds of crimes, specializing and putting people in charge of working it up for a useful prosecution. Especially in the case of the bankruptcy fraud, it involves a 2-year period of time in addition to that, and once the courts get it, I guarantee you the matter will float around for approximately 2 more years

before it's resolved. And that's even if it's not considered an extraordinary case. So the problem of prosecution in its reactive role is something that's not going to create the kind of business climate in a sudden way, for sure, that's going to discourage an influx of organized crime.

I'd like to take just a moment of time to talk about a particular story in Arizona where everything worked well, and where optimum results were achieved, and that's a story of a man by the name of Carman Feola. Through the coincidence of history, Carman Feola decided to locate in Phoenix at a very bad point in time, and all of the elements of what's needed to discourage organized-crime activity in this community are found in the story of Carman Feola. He was what is called a fire chaser, that is his business, that is the scam that he operates. He came from Cleveland. In Cleveland, fire chasers seek to represent the victims of fires with regard to their insurance companies. They have a lot of electronic gear that tunes in on police and fire bands and radios, they often arrive at the scenes before the fire trucks do and, at best, they practice hard sales techniques in offering to the distraught victim at that point in time to represent him against him insurance company. Offering to middleman, promising them higher recoveries for a percentage, again, of the take of his recovery. At worst, they create their own business by setting fires; they intimidate people in the field by bombings and burnings, they practice protection basically with that kind of racket, ordering that service to individuals who have not suffered a fire, and believing the implied threat they may well suffer a fire if they don't obtain services.

Carman Feola, for the reasons as I briefly described above, I think, decided that Phoenix and the valley would be a salubrious climate for him to locate his business in the future. However, he arrived about 6 or 7 days after Don Bolles had been bombed. There were that morning, for those of us who remember it in the room, about 2-inch headlines on the front page of the Republic; I think it said, "Fire Chaser Arrives in Phoenix." He immediately toddled down to the State insurance department, he filled out an application for an insurance license to sell insurance, and in connection with that license he lied about his previous criminal history. I think on the 11th day after he settled in town, after a relentless series of factual, truthful, and very revealing newspaper articles about his past and about his current intents in regards to his practice, he left, went back to Cleveland. A short time after that a case was worked up with the Phoenix Poice Department, was prosecuted by our office, and he had to, in fact, be extradited back to this jurisdiction where he pled to a charge of filing of a false document.

At that point in time Mr. Feola said, and this is a quote—"Laid the blame at the feet of the Maricopa County Attorney's Office and the Phoenix Police Department for, 'ruining my life'."

But we don't deserve the blame or the credit, however, it's perceived for that action, and that's the point I'm trying to make. We are a reactive mechanism, and we could only operate on Carman Feola, in fact after he left our jurisdiction. What happened at that magical point in time in Arizona for a brief, or regrettably brief, period of time was public awareness, combined with an active effort to uncover these sort of activities, combined with legislative reform.

The case on Carman Feola had to be dealt through another charge because we had an archaic perjury statute that didn't recognize that defects in the form of which an oath is administered should not be fatal to a criminal charge.

We now have a modern perjury law and it's a result again of that brief period of time of public awareness to which we can still to this day trace most of our modern laws in connection with this area in dealing with this crime.

What is important for this jurisdiction is to recognize the effective climate on organized crime; they make a business decision to locate just as any other industry does, an industry that is business-wide, legally aware, and certainly alert to the environment in which they grow and which they thrive. And the only way that, as far as Arizona's interests are concerned, which we can discourage their locating here is to create a change of climate. I think that's the most important thing, I think that's the only way that you can look at this problem of devise, and some sort of a cure that's going to be important and sensible.

If you try to dichotomize it and look to individual techniques to have a dramatic overall effect, I think you're misleading yourselves.

Senator DECONCINI. You get back to public awareness a great deal, do you not?

Mr. MURRAY. Yes; you do.

Senator DECONCINI. And what do you think law enforcement can do to increase that awareness? Do you have any suggestions?

Mr. MURRAY. I think there has to be a greater effort on the part of law enforcement to practice a relationship with the media in such a way that does not damage case work or investigations under way, but nevertheless can constitute some sort of an ability on the part of lawyers who are subject to the rules of the bar, after all, to nevertheless not get in trouble with the bar if we're talking about their work when it's in the public interest.

And we have an exception in our ethical canons for announcement of certain facts that may be important in the apprehension of a criminal if he's still at large.

I would like to see the rules expanded to a point where a lawyer could talk about ongoing criminal practices in the community in such a way that was not damaging to an individual's rights to jury trial and still practice a little preventative medicine.

Senator DECONCINI. What is your opinion of the attitude of the elective legislative bodies in Arizona?

Mr. MURRAY. Well, we deal before an elected legislative body that sits on Mondays where you're sitting now, the board of supervisors, and our experience with the board of supervisors has not been the best. In the history of our work with them my bureau, for example, practices not only organized-crime work but official corruption work. A lot of the county programs and processes that have gone on in the past have come under review of our own agency, and it's naive to pretend that our efforts to try to maintain a publicly responsible way of dispensing of some of these programs do not put us at, sometimes, cross purposes with our own funding body, and that's a difficult problem.

Senator DECONCINI. I realize you may not be able to speak for Mr. Hyder, but I take it you could use more resources from the standpoint of being able to be more effective and extend your investigations; is that true?

Mr. MURRAY. That is true. In fact, I could go a brief bit further and say that without certain kinds of high-level expertise, and the particular troublesome point is, as I indicated earlier, a strong, expert accounting help; there is a certain kind of case that we just can't do.

On my staff I represent the individual that has the most accounting experience, and that's 12 hours of accounting in college, and, believe me, I have trouble with my income tax forms every year. I can't imagine our being able to get into some of these kinds of cases without coming back to our funding body and asking specifically for contractually retained help, or getting that help regularly so we can call upon it when we need it, which, of course, would be much better.

Senator DECONCINI. Thank you very much, Mr. Murray. I wish to extend our thanks to your boss Mr. Hyder, and we thank you for and compliment you for your investigative expertise regarding the *Warren* case and many other cases.

Mr. MURRAY. Thank you, sir.

Senator DECONCINI. At this time we will recess until 1:30 p.m.

[Whereupon, a recess was taken.]

Senator DECONCINI. The subcommittee will come to order.

We are very happy to have you police officers here today, and I want to compliment you and your department and Chief Wetzel for the tremendous effort I know you have put forward in monitoring some of the organized-crime activities and being involved in many investigations. I am aware of the expertise your department has, and we appreciate your taking the time today in sharing your thoughts with us.

Please proceed.

#### STATEMENT OF CAPTAIN JERRY KIMMEL, ORGANIZED CRIME BUREAU, PHOENIX POLICE DEPARTMENT

Mr. KIMMEL. Thank you, Senator. It is a pleasure being here. I'd like to emphasize a few of the problems that have been discussed here today as they relate to Arizona and specifically to the greater Phoenix area. The point has been made that basically prior to 1975 land fraud, other white-collar crimes, organized crimes, were not, in effect, being investigated, there was a total lack of awareness by both the public and law enforcement in this type of problem. Regulatory agencies of the State and local governments, to say the least, were ineffective and of little, if any, value to helping us as law enforcement get a handle on this problem.

Unfortunately, in 1976 an event happened that, I think, turned us around, that was the contract killing of newspaper reporter Don Bolles. As a result of that murder, we had massive news media coverage regarding white-collar crime, organized crime, and which at that point in time, just basically a little over 3 years ago, there was still a distinction made between white-collar crime and organized crime. I was

pleased to note here today that this is not near the problem that it has been in the past; there is awareness now that white-collar crime basically is organized crime.

About 75 percent of the white-collar crimes that we investigate are connected in one way or another with organized criminal groups.

There have been some positive things that have taken place here, particularly in Maricopa County since 1976. The Phoenix Police Department was successful in obtaining a couple of substantial Federal grants to upgrade the training of our officers and giving them the expertise to work in these type of offenses that were foreign to us, and we were able to take advantage of that. And our command staff, in sitting down and trying to evaluate the problem, quickly realized that the mere monitoring and gathering of information on these groups was insufficient, that you had to formulate a prosecutive unit to take that information that you've gathered and put together criminal cases and start working on one at a time and gain convictions. Basically, that's what we have been doing.

Some other positive points—Maricopa County Attorney Charles Hyder formed a special unit of topnotch attorneys to prosecute white-collar organized-crime cases that we were putting together. The Arizona attorney general's office became extremely active in criminal prosecution, which brought it out into the statewide area. The Arizona Department of Public Safety formed an economic crimes unit. Federal law enforcement agencies brought in task forces to deal with white-collar crime. These were all positive points which have really given us a start in bringing the problem under control. However, with all of this attention, there is really no indication that the problem is going to ease in the future, and we, at best, have just gotten a good start.

Cases that we have investigated in addition to the more traditional contract killings, extortion, narcotics smuggling, interstate gambling, other major crimes that we have investigated that are truly just as organized, is land fraud, diamond investments, distribution of hard pornographic materials, planned bankruptcies, and the other assortment of white-collar crime. Most of these involved organized criminal activity of some type or another.

The dollar impact on the public in the cases that we have investigated, that we personally have been involved in, have been hundreds of millions of dollars. Many of these cases gave the appearance at first of being legitimate business operations. They were very complicated and very time consuming to investigate. It was hard for our citizens, and it was hard for us to even recognize that some of the long-standing, highly respected individuals of our community were involved in some form or another with some of these organized crime operatives.

In the last 5 years we estimate in just the cases that we have investigated over one-half billion dollars in losses to the general public as a result of these land frauds and diamond investments, bankruptcy bustouts, and the other miscellaneous scams that these people have been involved in.

We've made a start, as I've said; however, there are still some problems that we feel need to be overcome that would make us more effective than what we have been in the past.

The investigation of white-collar crimes and organized crimes, that we have all talked about here today, requires a lot of expertise and requires a considerable amount of manpower. Our office has to become knowledgeable in accounting procedures, computer intellects, civil law pertaining to business operations, investment scams, just to name a few of the nontraditional police functions that prior to 1975 we didn't investigate. We're only talking about 4 years ago. Needless to say, these investigations have had a heavy drain on our police resources. We've had to train, we've sent officers to California to the Department of Justice who have some excellent courses over there, we have sent them to seminars, to workshops, and our own academy has instituted some training programs to give our officers the tools to perform successfully in these areas.

In addition, the organized crime bureau, other units, other investigative units of our department have been deeply involved in assorted programs such as sting operations, arson task forces, major offender programs; many of these activities have also indicated organized-crime ties.

Some of the future problems that we feel are important, that need to be dealt with, is a clear understanding of what organized crime is, not necessarily the definition, but a clear understanding that its scope is much broader than just the traditional Mafia element. Training will always be a problem. We need constant, continuous, more sophisticated training for our people. Investigative travel, very expensive for municipal agencies like my own, to provide the funds necessary for an investigator to travel to three and four and five States to follow up on investigative leads, serve search warrants, obtain documents necessary to prove a major fraud that they're involved in.

In short, there's more funds needed for this type of work and, unfortunately, a unit like the organized crime bureau is in competition with street crime that has a very visible impact on our community. And it's pretty hard for myself to go to my police chief and ask for substantial increases when we still have a tremendous problem in the street crime, because of our constant growth here in the community.

Obtaining Federal grants was mentioned earlier by some of these other gentlemen testifying here this morning. Obtaining a Federal grant is a problem in itself. The documentation necessary to obtain a Federal grant is very difficult. The manner in which a Federal grant has to be written up is very complicated. Hundreds of hours of staff time is utilized just to put together a document that meets the Federal guidelines. Perhaps, as a suggestion, a less complicated method would suffice.

Perhaps a revenue-sharing concept, where the State, county, local governments would be given a number of dollars to spend in what manner they feel is important. It really isn't practical to have your local priorities set for you on a national level. Our problems and our conditions here locally are different, I'm sure, than those other sectors of the country. I think the State, county, local jurisdictions need to have that prerogative right here. We need to have more latitude in developing what our problems are, and then be given the funds to deal with those problems.

Also, when you talk about Federal grants, it doesn't really help police officers or police departments to obtain large sums of money if

your prosecutors and your courts are shortchanged. If one part of that system breaks down, the whole system breaks down. It has to be a coordinated effort, the same as our investigative efforts have to be coordinated between the State, county, and Federal people.

There is somewhat of a problem in cooperation with Federal jurisdictions, not because of personality problems between investigators or prosecutors, but because of different priorities that have been set, perhaps on a higher level. The burden of working within your statutes that you have to work in, the Federal statutes being more restrictive than the local statutes to where it's actually a crime for a Federal officer to reveal to a State officer or a municipal officer certain elements of an offense that they have taken to the grand jury, and they're bound by the laws that apply to that grand jury. This is a problem that, I think, our Federal people make policy, direct policy, and my police chief and people of this nature need to get together and work out these problems. I think that those problems are brought about by, like I say, our systems, and not by personalities.

That's the only comments I have here as an overview, Senator; however, I do have several of my police officers here that specifically can go into some details as to problems they have uncovered in the bankruptcy laws, if you would like.

Senator DeCONCINI. Thank you very much, Captain Kimmel.

Let me just address a couple of things to you first. You talked about the street crime being a priority, and surely it is, and I understand that. It effects our safety of our homes and our children, what have you. Do you find a lot of street crime related to narcotics and other activities which are associated with organized crime?

Mr. KIMMEL. Certainly. A narcotic organization through its agents create a lot of misery within a community. Narcotic addicts have to steal an awful lot of money to support their habits, and it creates a lot of crime with violence to obtain that money; that's just to name one factor. But organized crime definitely does have an impact on street crime, there's no question about it.

Senator DeCONCINI. You raised a very good point that the system is only as good as the whole system, the prosecutor and courts. What has been your analysis, and you don't have to be specific as to any individual court, but of the State courts here in their sentencing of organized crime defendants that have been convicted.

Mr. KIMMEL. Prior to 1977 I was disappointed in the sentencing that was being handed out by our judicial judges; since that time I think there has become an awareness on their part, and I have been encouraged by the sentencing that has been administered here in the last couple of years.

Senator DeCONCINI. You say it has improved substantially since 1976?

Mr. KIMMEL. Yes, since about 1977.

Senator DeCONCINI. Another thing that is always of interest to me is the level of cooperative effort among law enforcement agencies. I always remember so well when I was prosecuting attorney, you always hesitated to criticize anybody, but we used to have horrendous problems with the FBI, and lack of cooperation. We could sometimes work a case together, but it had to be to their advantage to do so.

You have been in Phoenix for sometime now; would you care to comment on the present cooperative efforts within the law enforcement in Arizona and if it has improved in the past 5, 10 years or so?

Mr. KIMMEL. I would be glad to. I have been a police officer here in Maricopa County 25 years. Our conditions here were the same you experienced in Pima County, I am sure. However, specifically, in the last 3 years I do not see that as a major problem, specifically, without naming cases. We are now currently involved in at least five cases with the Federal agencies, two or three of those cases with local FBI unit, very substantial cases, they are very important cases to this community.

Senator DeCONCINI. Are those organized-crime cases?

Mr. KIMMEL. Yes, sir. And there is a willingness to cooperate among the individual investigators who are assigned to work these cases. The only problems I have, again, is that we run into problems of priorities and law and that type of thing that create those stumbling blocks, and often times create some hard feelings. We have to be always aware of that problem, and as managers we have to take steps to try to keep that from becoming unworkable.

Senator DeCONCINI. Do you find it advantageous to have sufficient prosecutors involved in the early stages to advise law officials?

Mr. KIMMEL. It's imperative.

Senator DeCONCINI. Do you have that now?

Mr. KIMMEL. Yes, we do have that. Yes, with both the Maricopa County attorney's office and with the attorney general's office. As soon as one of our investigators starts formulating the case and he sees where this case is going to go and has some idea of its extent, at that point in time we will bring in a prosecutor, and we have real good success with that, and we will try to keep them aware of the case just as we go right along making our investigation.

Many of our organized crime cases, as you can understand, were—electronic surveillance are part of them. I have a deputy county attorney that works in my office that actually helps us draw up the necessary paper work for that.

Senator DeCONCINI. He's physically in your office?

Mr. KIMMEL. Physically located in my office.

Senator DeCONCINI. He can give you advice on any number of items.

Mr. KIMMEL. Number of things, between my department and his office.

Senator DeCONCINI. How long have you had that arrangement?

Mr. KIMMEL. Since 1977.

Senator DeCONCINI. Regarding bankruptcy, is it a growing problem with more bankruptcies, or bustouts, or has it tapered off, as Mr. Hawkins seemed to indicate.

Mr. KIMMEL. Well, we, as a municipal agency, don't work the total aspect of bankruptcy, as you can understand. However, I am hard pressed to remember a major fraud that we haven't worked that bankruptcy wasn't a factor.

Senator DeCONCINI. When you say "a factor" a premeditated part of the scheme?

Mr. KIMMEL. It was a plan of the scheme to bustout that operation.

Senator DeCONCINI. In your experience is that partly due to the law

being so available and vulnerable, or is it more due to the ease with which credit is obtained?

Mr. KIMMEL. I would say both. I think that they're taking advantage of the law to further their criminal violations, and I think there was probably a lack of an awareness on the part of financial institutions and others who were becoming victims of these scams, which I think has improved considerably here in the last year or so.

Senator DeCONCINI. Qualitywise, do you have any estimate of how many white-collar crime cases that your department is working or has worked that involved bankruptcy?

Mr. KIMMEL. We investigate and submit for prosecution approximately 60 cases a year, that's the work product of about 16 police officers. I would say that probably at least 50 percent of those cases involve some aspect of bankruptcy.

Senator DeCONCINI. And were all those cases, in your definition, organized crime?

Mr. KIMMEL. About 75 percent of them.

Senator DeCONCINI. Captain, you make some good points about Federal grants. Unfortunately, I see less Federal money available instead of more, unless we shift some priorities in this country, and maybe we will, if we can develop the awareness.

I appreciate your testimony and underscoring the public change in this community; I think it's very evident, also, and I am glad to see that people who are in the trenches, so to speak, are getting more support.

Mr. KIMMEL. Thank you.

Senator DeCONCINI. One more question. Do you find an increased awareness about the dangers of organized crimes among the elected officials that you deal with both on a city level and a State level?

Mr. KIMMEL. Yes, I think there is an increased awareness of the problems, but they have many problems they have to deal with. I hate to be critical of my disappointments in not obtaining the funds I would like to obtain, when I look at the broad scope of problems that they deal with, and the limited resources that they have available to them.

Senator DeCONCINI. You are a good politician then.

Mr. KIMMEL. Thank you.

Senator DeCONCINI. Along that line, is it safe to say you would like to see more emphasis placed by the legislative bodies to provide the resources for expanding this type of operation?

Mr. KIMMEL. Yes, sir.

Senator DeCONCINI. Thank you very much, Captain. We appreciate it.

Anybody else?

**STATEMENT OF DETECTIVE JOHN BEARENTZ, ORGANIZED CRIME  
BUREAU, PHOENIX POLICE DEPARTMENT**

Mr. BEARENTZ. Excuse me. Detective John Bearentz, Organized Crime Bureau. I would like to talk to you specifically about some bankruptcy frauds, some that are rather recent, some bustout-type situations that are even more recent.

During the course of another investigation, sometime ago, I developed an informant who had been involved in white-collar crime for the last 20 years all over the United States. This individual, of course, for his own safety, won't be named at this time. He's knowledgeable in the areas of white-collar crime and is also acquainted with, I'm sure, some of the people shown on that map. This individual, in talking to him about bankruptcy and bankruptcy frauds, spelled out to me how a bankruptcy fraud can be planned to an individual or corporate advantage; he's done both, personally. His own personal bankruptcy that occurred sometime ago was done in an effort to protect his own personal property as well as kind of cleaning the slate. This slate cleaning was manifested because of the type of white-collar offenses he's been involved in over a period of years, that result in numerous civil actions being filed against an individual, and these white-collar criminals generally accept that they will have lawsuits coming out the ear, so to speak. These bankruptcies can be used to clear these lawsuits, to safeguard their own personal property, and generally make money.

This individual's personal bankruptcy—he had over one-quarter of a million dollars in outstanding lawsuits pending against him, he also had a very expensive home, furnishings, cars, and so forth. In structuring this bankruptcy he advised that organized crime over the years had explained to him how it could be done, how to do it, and what the advantages would be; he did it very well.

He also explained that oftentimes you need a little ready cash to get by during the process of going through this bankruptcy, so with the help of an unscrupulous banker or loan officer, and in his particular case he used an 8-year-old automobile as collateral for a \$50,000 loan. As soon as the money is received, a certain percentage is kicked back to the banker, the loan officer, and that's the way it goes until the bankruptcy comes down and the slate is clean. As you can see, very readily, you don't have to do that very often to make a profit.

One of the other methods that were being used, of course, was these individuals involved in white-collar crime quite often have numerous corporations or shell corporations available to them, some that they've purchased or formed years and years ago, and simply lie dormant until needed. Prior to a bankruptcy, a planned bankruptcy, these individuals might rekindle several of these shell corporations, and here list them as creditors in their bankruptcy. Of course, our bankruptcy courts, according to him, don't delve into it too far, so it's very easy to disguise the actual ownership or control of the shell corporations, and after the bankruptcy is completed he, in essence, still controls or owns the property that he's shown to be—where these shell corporations have been creditors, and thereby still retaining ownership, and whatever it may be, cars, houses, bank accounts.

Right after the personal bankruptcy, he formed another corporation in another State, within a year this corporation went bankrupt, listing the same shell corporations as creditors; I think there was another large loan involved, and the process goes on.

This bankruptcy also concealed a small land fraud that is also under investigation here in Arizona. He's very candid about the whole thing. He's indicated that one of the problems in the bankruptcies, insofar as we're concerned, is that the officials involved in the bankruptcy are

all too often only getting their jobs done easily, and oftentimes at their best interest, there was little or no regard to creditors or petitioners.

The popular concept being, as he explained it, make sure there is enough assets available, which oftentimes doesn't have to be that much, but a sufficient amount of cash available, so that the employees receiving, the trustees receivers, or whatever, are paid, because that's where the primary concern often lies.

Due to having this informant available, for a change we are working a little bit closer to the actual time of occurrence, but there are also two bustouts under investigation right now that occurred less than 6 weeks ago right here in Phoenix. There is some indication, here again, because they are under investigation, and can't go into much detail, but these two appear to have a good, strong possibility of organized crime links, and, once again, the people of Arizona have suffered a loss.

In talking to him and reflecting on what he said, and as an investigator, what I found to be true, I'd like to express to you that I feel there is a definite need for prosecutors. First of all, they've had the time to experience expertise, if you will, to actually pursue these cases, as well as a need for investigators with time and money to complete the complex cases.

At the present time, both at the local level, prosecutors and investigators are carrying workloads that kind of preclude getting involved. Oftentimes they also hamper any further education on our part to be able to investigate these complex business frauds.

Thank you.

Senator DeCONCINI. If you get into a bankruptcy fraud, would the local prosecutor prosecute the case? You have to find some State offense; right? Are you able to find any State offense in any of these cases?

Mr. BEARENTZ. Yes, there is. Normally, though, in the bankruptcy fraud, if we uncover that during the investigation, the FBI will take care of it.

Senator DeCONCINI. It is then up to the U.S. district attorney?

Mr. BEARENTZ. Right.

Senator DeCONCINI. How long a period, of the example you gave, did that person operate? How many years was he able to operate?

Mr. BEARENTZ. Almost 20.

Senator DeCONCINI. Here.

Mr. BEARENTZ. All over the United States.

Senator DeCONCINI. How long did he operate here?

Mr. BEARENTZ. Approximately 3 years.

Senator DeCONCINI. Was he convicted?

Mr. BEARENTZ. Yes.

Senator DeCONCINI. Do you have any estimate of how much money he took down here before he was caught?

Mr. BEARENTZ. As an example, he's quite proud of the fact he's never paid income tax in 15 years, and his wife's personal checking account had just under \$1 million in it in 1976.

Senator DeCONCINI. You didn't make any estimation of what the loss was here?

Mr. BEARENTZ. He has no idea, specifically.

Senator DeCONCINI. Is he in jail now or is he a witness?

Mr. BEARENTZ. I'd rather not comment on that.

Senator DeCONCINI. All right. Very good.

**STATEMENT OF DETECTIVE TERRY RHEL, PHOENIX POLICE DEPARTMENT**

Mr. RHEL. Terry Rhel, also with the Phoenix Police Department. At this time, briefly, I would like to go into a bankruptcy that is involved, among other things, on current investigation, so due to this, certain firm names will not be used. Hopefully this will show, even though the story is about the same as those you have heard in the bankruptcies, the exact placement of organized crime ties to Phoenix, and the problems that were incurred and gotten around in the Federal bankruptcy cases. For publicity sake, the firm that was eventually bankrupt, we will call Company A. At one point in time this firm needed more working capital, and he shopped around until he was recommended to an individual who had a holding company, and was also known as a management consultant, who had money to inject into this business.

The holding company I will name Firm X at this particular time. Firm X agreed to take Company A over for a trial period. And for the privilege of allowing his company to be taken over, the head of Company A was given a stock transfer between the two companies, he was also paid a monthly consulting fee amounting to several thousand dollars a month, which is more than he was making as the head of the company, and he was also retained as president of that company.

Firm X took over, and within 2 days of the takeover several things were accomplished at this time. The first thing was that only checking accounts were opened for all of the various Company A outlets, the store manager in each outlet was a signer on the account and also one employee from Firm X. Company A's accounting section, they had a controller and four accountants, they were allowed to retain the accounts receivables, all checkbooks and all accounts payable were taken over to Firm X and that's where they remained for the entire length of this.

Also, at the same time, a known organized-crime figure from one of the New Jersey families was named chief of security for Company A, he arrived in Phoenix, spent time here, also in California, and went back to New Jersey. His duties weren't taken too seriously. During the run of the bankruptcy, select employees from Firm X were allowed to go into Company A's outlets, charge all manner of merchandise and simply sign for merchandise; no payment was ever received, none was ever offered back to Company A.

Later, both sides alleged that the other was moving large quantities of this merchandise out the back door. There was an increase in stock during this time, the typical scene where the stock was increased but it never showed up in sales. Approximately 2 months into this agreement, Company A checks started getting written to individuals all over the United States that were in no way involved with Company A's business, they were personal friends of the head of Firm X and several of the checks were written again to another different organized crime figure in New York.

A week before the original owner regained control of the company, the armored car service to all of Company A's outlets was stopped, and an unknown individual, and he is still unknown at this time, went around daily and made all of the cash pickups. Company A's owner later stated that he became aware approximately 3 months into the trial period that there was some form of wrongdoing being perpetrated by Firm X, he went to the head of Firm X and said that if he didn't return control to him, that he was going to go to law enforcement. Firm X very meekly submitted to this, and the stock retransfer, if you care to call it that, took place between planes at Sky Harbor Airport.

The total time Firm X was in control of Company A was 4 months, and 6 days after regaining control of the company, the original head of Company A filed petition for chapter 11, bankruptcy, with the Federal court here in Phoenix. Now, the interesting thing is that during the hearing Firm X and several of its subsidiary companies filed claims which amounted to, I believe, roughly \$12,000, which is a minuscule sum compared to what was actually taken out, but they filed a claim against Company A in the bankruptcy hearings. The entire hearing in court was done without any books or records. There was some reconstruction done on the part of the receiver through checks, but the majority of books and records, each side pointed at the other one and said: I gave them to you. You have them. No, I don't. And you can see where that goes.

Partial records which belonged to Company A which have been testified to in bankruptcy hearings as being nonexistent, were, a year later, still in the possession of Firm X. And I say partial; the total records, I don't know if they were there.

There were allegations made during the bankruptcy hearing, a period of time after that, to the court, to various other individuals that there was fraud involved, and there was no action taken on this. No one paid any specific attention to it, even though the total circumstances during the bankruptcy hearing should have pointed to something. That is strictly my opinion. The four main individuals involved—the original head of Company A, after bankruptcy, he moved to another State, and once he got there he was hailed as a business genius; why, I still haven't figured out. And he got involved in several other companies. He stayed with these companies, several of which merged, one went bankrupt, and he was just recently indicted in this other State for various business frauds.

The organized crime figure that was the chief of security, brought in by Firm X to take over Company A left that position when Firm X returned control of it, but he was continued to be paid various sums for consulting fees from Firm X for the next 3-year period; he was paid these fees. He also shows up peripherally in connection with the original head of Company A, and the other, after he moved to another State, he appeared again.

There is always one man up front, and on Firm X, it was a man who, if any checking had been done 6 months prior to him taking over Company A he had filed as president of a nationwide firm based on the east coast, he had filed for chapter 11 on the east coast, and during the same time that he was running this company here, he also filed

chapter 11 as president of another east coast firm, and he was just recently convicted in Federal court on a fraud involving Government loans to the second east coast firm.

The head of Firm X is still operating, and being a much smarter individual, he never declared bankruptcy, and his name is never up front. His firm, his holding company, whatever you care to call it, was involved, and its name was involved with at least three of the bankrupt firms, and also with six others that went—just total walkaways. He appears to like the walkaway concept to do business as opposed to bankruptcy, and it has never damaged his credit. He has buried six legitimate companies in Arizona alone, and I am not sure how many on the east coast and in other places.

Senator DeCONCINI. Do you have any estimate of the value of what those companies were?

Mr. RHIEL. Conservatively, just in Arizona, \$2 million that were taken out the total, I am sure, will go up if it can ever be discovered what the exact loss was back on the east coast and in other States. Moneys from the firms that were walkaways, from the bankrupt firms, were channeled to various organized crime figures; there is hard evidence indicating this, showing that it did go to these people.

Senator DeCONCINI. Including the people from New Jersey?

Mr. RHIEL. New Jersey, New York. This individual seems to operate between family lines. He is not made in any specific family, but he can operate between the lines, and has. He operated in Arizona for 5 years. But as I say, the sum, conservatively, \$2 million, is low. The overall scheme is yet to be brought forth.

Senator DeCONCINI. Thank you very much.

Mr. RHIEL. Thank you.

#### DETECTIVE LONZO McCracken, PHOENIX POLICE DEPARTMENT

Mr. McCracken. I am Mr. Lonzo McCracken, with the Phoenix Police Department. I want to talk a few minutes about white-collar crimes, corporation setups, for the purpose of stealing money.

Most of these corporations are set up to sell some type of bogus paper, phony paper, be it a note, mortgage, stocks, bonds, whatever. In an example of the land companies that have operated here in Phoenix over the last 15 years, it would be my opinion that the real purpose of these companies was to sell paper, not land; that's where they generated their large source of income. They sold to some legitimate land buyers, and intermixed with that when they sold the notes and mortgages phony paper that was prepared in various ways, including forgeries. The money in these corporations was siphoned out in various ways, through shell corporations, like Officer Rhiel described, and the ultimate goal was to place these companies in bankruptcy.

I am happy to say over the past 6 to 8 years that numerous individuals employed and operating these companies have been convicted and put into prison here in Arizona, both by the Federal authorities and the local authorities. The net result of this is that these operations have moved to other States, States that don't really have the laws to handle the problem.

Senator DeCONCINI. Do they totally move, or do they just continue to operate and pick up someplace else?

Mr. McCracken. No; they totally move. They moved into Oklahoma, Utah.

Senator DeCONCINI. As far as you know, the people are gone from here?

Mr. McCracken. Yes; and they have actually opened up new land frauds in those States, so the biggest prosecution that's occurred here had the net results of just moving to greener pastures, and I have talked to prosecutors and officers of those other States.

Since we have had the problem in Arizona, the legislature has passed new laws, giving us new tools to work with here. The problem in these other States, according to these other officers and prosecutors I have talked to, is that they're still back where we were 10 years ago. They really don't have the tools we have now; we're way ahead of them. Then, each of these companies are designed for bankruptcy, that's the ultimate place they're going to go, and we lost to the people around the United States in just land fraud alone, probably half a billion dollars over the past 10 years or so. That isn't counting your advanced fees schemes and your bond scams and that sort of thing.

Senator DeCONCINI. In your opinion, gentlemen, either collectively or individually, what changes are needed in order to reduce misuse of bankruptcy laws?

Mr. Kimmel. I think it needs to be revamped. New legislation, and somehow the possibility of closer scrutiny as far as these bankruptcies are concerned, from what I have seen, at least, might be in order.

Senator DeCONCINI. You mean careful scrutiny, you mean as to the fees for the trustees, and administration of bankruptcies?

Mr. Kimmel. I mean the bankruptcy itself, the individuals that are involved in it.

Senator DeCONCINI. Even the ones appointed by the court?

Mr. Kimmel. I am talking about the people that are filing the bankruptcy themselves. If there was some type of a police agency that would be in a position to take the time to do a background on the individuals involved, it might help.

Senator DeCONCINI. It might at least alert somebody?

Mr. Kimmel. Exactly.

Senator DeCONCINI. Any other comments?

Mr. Rhiel. Yes. I think the history of some of the bankruptcies here in Arizona—I don't know if this is true today, but it was true, say, back in the late sixties and early seventies—a trustee would be appointed after the petition was filed, that trustee in reviewing the records of the bankrupt corporation has to see the fraud in there. There is just no doubt, he's got to find it. Back in those early days, this was never reported to the county attorney or the attorney general or the U.S. attorney.

Senator DeCONCINI. Some mandatory reporting would be helpful?

Mr. Rhiel. Another thing that might be helpful is—and I don't know if this exists, but if it doesn't, it should—trustees that are appointed should be required, possibly by law, to have some credentials showing they have experience to handle the situation; I think that would be handling it the best.

Senator DeCONCINI. Thank you, gentlemen, very much.

STATEMENT OF SERGEANT JAMES MADISON, PHOENIX POLICE DEPARTMENT

Mr. Madison. Senator, thank you very much for inviting the department to testify before the hearing this afternoon. I did a good bit of listening all morning and this afternoon as to what the other people had to say, and our position is very much the same as those who testified earlier. I will try not to be redundant and testify as to some of the things you have already heard.

We are very concerned about organized crime and the effects it's had on Arizona in the past, and the effect that it's currently having today. There has already been testimony as to some sort of definition of organized crime, and I think we referred to it earlier as traditional organized crime and nontraditional organized crime; I will attempt to use those same definitions.

Our position insofar as the traditional organized-crime effect on Arizona today is that we have had and we presently do have traditional organized-crime people residing and doing business within the State. These people are closely related to the midwestern, the east coast, the west coast groups, and the occurrences that happen there, however, their major effects on Arizona do not come from the activities that have traditionally been associated with their particular groups elsewhere.

Senator DeCONCINI. Excuse me. When you are talking about groups, you are making reference to what?

Mr. Madison. I am referring to the organized-crime family groups.

Senator DeCONCINI. These are people who were earlier classified as "soldiers"; is that what you are talking about?

Mr. Madison. Yes; the traditional Mafia family, the Cosa Nostra or the syndicate; those are the groups I am referring to. The activities that have been associated with these particular groups, hijackings, major gambling enterprises, major control of prostitution, pornography, fencing operations, and so forth and so on. The difference between those particular kinds of crimes and what is occurring in Arizona today is the investment of these moneys are being brought to Arizona, and large sums of moneys are going into land purchases, legitimate businesses such as bars, restaurants.

I think primarily their influence can be seen in the economic power that they develop, and this affects the local and State officials; it affects business leader in the community, and indirectly it affects business decisions and other decisions that are made by officials. I think their influence has very much of a corrupting factor that evidences itself in kickbacks and payoffs and the moral and ethical conduct of officials and business decisionmakers. I am not attempting to indict all, obviously, public officials and all business—

Senator DeCONCINI. You think they have a significant influence in the normal community life?

Mr. Madison. Yes, sir, very much so.

Senator DeCONCINI. In addition to how they might have made their money through illegal activities?

Mr. Madison. When one comes into this State, for instance, invests in large landholdings, buys businesses, fully legitimate businesses,

after a short period of time they attain a certain stature of influence within the community.

Senator DeCONCINI. I understand.

Mr. MADISON. This influence, I think, is very pervasive into every activity of every life for all our citizens.

Senator DeCONCINI. Do you think it's expanding greater today than it was 5 years ago?

Mr. MADISON. I think it has, but I could not give you a definitive answer as to why I would say that.

Senator DeCONCINI. Your investigations indicate that some of these individuals have established some very strong legitimate ties and even some appearance of legitimacy themselves?

Mr. MADISON. Yes, sir, without question.

Senator DeCONCINI. Such as belonging to exclusive organizations.

Mr. MADISON. I am talking about controlling large sections of geographical areas, and I think the western portion of the State shows very much evidence of that: large landholdings, businesses, so on. Properties are owned by corporations that are directly controlled by people in the traditional organized-crime families. The western part of the State is not the only exclusive portion of the State where it occurs; it's occurring in Phoenix and elsewhere in the State.

The nontraditional organized crime that we have all referred to earlier in the day, what I would like to do is give you a representative idea of how that's influenced us in the past, influences us today, and possibly run through a land fraud that occurred several years ago here, that not only involved just land but it involved investment frauds, involved insurance frauds. It was kind of a culmination of the different and various frauds that had been perpetrated, and then I will hopefully apply that methodology that was used to some of the things that are ongoing today.

Very basically, this particular fraud started with an insurance company that was put together by some organized-crime people; they put an insurance company together for very little money, and to finance the insurance company the assets of the company were inflated with a land fraud company using the assets from the land fraud company—two companies, one being an insurance company, one being a land fraud company, and the assets from both companies were transferred back and forth, inflating the books and so on of each company, therefore evading audits by the State regulatory agents.

This continued for seven years. Then using assets they had gained in this manner, they purchased a large section of land in northern Arizona, in excess of 1,200 acres, the purchase price was for approximately \$60,000; the phony price, as indicated in their books, was \$1 million. They subdivided this property and proceeded to gether a group of professional conmen and salesmen from all over the country, put them together in a large team, and this team traveled throughout the United States, including Arizona, and overseas, selling land to servicemen.

As Detective McCracken testified to earlier, that he believed that they were selling investment papers is really what they were selling, and that is the truth. They sold land, and most of the land was sold on contracts. The contracts and mortgages were then turned around

and sold to other people investing in the contracts. There were multiple contracts sold on the same land, multiple mortgages, oftentimes insurance policies were issued in conjunction with the land. The insurance policies, for instance, if they were unfortunate enough to have a victim die, the insurance policy was to pay the land off, frequently never gave lien clearance on the land.

They continued to pay the investor, bring him along, make his monthly payments out of the total moneys they had accumulated. Ultimately knowing the company had to go bankrupt, there is no way this corporation could continue to function, but in the interim period millions of dollars were siphoned out. I think this enterprise went on for 4 years, and over a 2½-year period of time they took out an excess of \$5.5 million.

Now, the sad point is that when the victims realized the company had gone bankrupt and they had been involved in possible fraud, many of the salesmen involved in this very same promotion contacted the victims and told them that if they would send them \$200 or \$300, or however much they felt they were good for, at that point they could become involved in a lawsuit against the original company, a joint lawsuit, so they were victimized there, as in many other frauds when they go into bankruptcy, and the problems continue for the victim.

Many of these things are long and drawn out, a great deal of time is spent by attorneys, so there is a good bit of money drawn out of whatever assets are remaining in the company to pay the attorneys and those involved in the actual administrating of the receivership. It's a terrible, terrible legal hassle for many of these victims; I have talked to some of them and it's really heartbreaking to find out how much money they have lost and how little they have got back, if any. Some real attention needs to be paid to this particular aspect.

Now, using that particular methodology, how is it being applied today? We do not have the large land frauds that we had in Arizona several years ago; they have moved on, but we do have other types of fraud that are used in the same methodology used in the selling of land. We have franchise frauds, where franchises are being sold, tremendous promises and guarantees are being made to investors which are never met.

An interesting point today, and it's very much timely with the energy problem, is energy scams and energy frauds that are being perpetrated. Right in Phoenix today we have multiple corporations headed up by a group of individuals who use these corporations to transfer their assets and phony assets and responsibilities back and forth between corporations. These corporations are involved in a nationwide fraud, in that they are promoting, I should say, investments in energy devices, energy concepts and energy methodology. They are very slick, they use all kinds of advertising, they develop portfolios which, for the most part, are entirely phony but they look great to the investor, and they sell stock in these companies, primarily. And the sad fact is that most of the people who have invested in these several particular corporations, they are not willing to complain too loudly, for a number of reasons; No. 1, if they complain to the police and the police come in and start to investigate it in the corporation, they will not get their moneys back if it is a fraud, and they keep

hoping against hope that it's not a fraud, and the cycle continues on and on and on.

In addition to that, another fraud that seems to keep coming back is the advanced fee. Today money has been very tight, hard to get, and to receive credit you have to have substantially more sound background, so the advance fee schemes are very prominent now. We have organized crime people in the Phoenix area who are loaning money at tremendous interest rates, if they are fortunate enough to receive the moneys, but they are also loaning, pretending to loan the money, and continually bleed people for certain fees in advance so that a loan can be arranged, and most of the loans do not come through.

Those are just a couple of the things I wanted to talk about with you this afternoon.

Senator DECONCINI. Do you have active cases on gold and other metals and diamonds?

Mr. MADISON. We have active cases on diamonds, we are also working the mineral and mining investments in lieu of land for land investments. We now have people who are selling investments in gold mining claims, silver mining claims, land that contain—just buy the whole mine outright, and so all that is just a continuation of the land fraud, only now with the emphasis being placed on the gold.

Senator DECONCINI. With your experience, Sergeant, what do you feel is the best weapon to combat this sophisticated operation? You know, you leave me with a distinct impression that these people are pretty bright. They know how to use the law; they are not fools. Do you have any observations that come to you that the law ought to be changed either at Federal or State level?

Mr. MADISON. As far as the State level, I think we have excellent laws. I couldn't comment on the Federal laws. I am satisfied with it though.

Senator DECONCINI. What do we need? More personnel, more sophisticated investigators, accountants, and that sort of thing?

Mr. MADISON. Yes, sir. The answer is yes to your question. We need money.

Senator DECONCINI. It is a shortage of sophisticated law enforcement people, in your opinion?

Mr. MADISON. And I think the public, to support this, has to be informed, and that's what I like about a hearing like this.

Senator DECONCINI. I hope that is one of the things that comes out of this hearing. It certainly has got to be an eye-opener to the public to know what is going on right here in the beautiful valley of the sun.

Mr. MADISON. I would like to be able to name names and tell it all, but I obviously can't.

Senator DECONCINI. I understand. How many bankruptcy cases does your department involve itself in over a 12-month period; can you give me any estimate?

Mr. MADISON. Normally our unit division does not work bankruptcies, per se.

Senator DECONCINI. They are secondary? How many do you come across in a 12-month period?

Mr. MADISON. In a 12-month period, I believe we worked 35 cases in a 12-month period of time.

Senator DECONCINI. How many people are in that division?

Mr. MADISON. In our particular division?

Senator DECONCINI. Yes.

Mr. MADISON. Approximately 30.

Senator DECONCINI. Thank you very much. You are most helpful to us, indeed.

The witness is a prominent Scottsdale lawyer, Mr. Charles Duecy.

**STATEMENT OF CHARLES DUECY, ATTORNEY, SCOTTSDALE, ARIZ.**

Mr. DUECY. Senator, Mr. Feidler, and Mr. Christensen, I am glad to be here.

Before I make any remarks, I would like to identify myself. I am Charles Duecy, from Scottsdale, Ariz., private practice.

Anything that I say here, I would like the committee, chairman, and the folks here to understand that I speak from my personal prejudices as a plaintiff's lawyer, and my frustrations speak not for the law enforcement but for the attorneys who represent thousands of people, and I mean thousands of people, who have been defrauded out of millions of dollars by people, in using my definition of organized crime, who are involved in organized crime. I am not going to try to use the term "traditional" or otherwise.

First, I would like to say I have furnished the committee a memorandum, and prior to this hearing I gave it to the committee staff.

Senator DECONCINI. If you have no objection, we will enter that in the record.

Mr. DUECY. I would like to have it entered in the record. I would prefer to have it in the record; it is rather lengthy.

Senator DECONCINI. It will appear.

Mr. DUECY. I think I have, in detail, what organized crime is, what my hopeful solutions are.

I would like to have the memorandum made available for any persons who might, including the press, who might request it. I would prefer not to be named in that, in any publicity connection with it; I think you will understand.

Senator DECONCINI. I do.

Mr. DUECY. The other thing I would like to ask the committee's indulgence in is that I can speak of incidents, organizations, A, B, C; or people, A, B, C; or I can speak factually from facts that I believe are part of the public record, and I don't believe that they would violate any law in disclosing. Would the committee prefer me to mention names, or would you like me—

Senator DECONCINI. Mr. Duecy, the more realistic we can have these hearings, the better it's going to be for other members of the committee. I am knowledgeable of some of the cases you have been involved in and some of the people that have been involved. I will leave the rest to your discretion.

Mr. DUECY. Thank you. The staff asked me if I had any current cases. Now, before I comment on the cases that I am going to touch on, I would like the committee to understand that I represent a small law firm, there are four principal attorneys, and we have probably seven people in our office, attorneys. The number of actions involving bank-

ruptcy and organized crime that come to our office are naturally a small, small percentage of the total that occurs throughout the United States, so bear this in mind when I make my comments.

I am going to refer to four cases that are currently in our office and active, that involve what, in my definition, is organized crime, and I will come to that in a moment, and bankruptcy, because I understand that is the committee's purpose in coming here, is to find the connection or relationship, if possible, between organized crime and bankruptcy.

To me, the definition of organized crime, if I may very briefly explain it, is a situation in which a fraud has been perpetrated, or not a fraud, but several frauds, probably nationwide in aspect, in which you see the same names and the same format used repeatedly, and in which there has been either civil fraud proven or criminal fraud, a Federal civil action restraining them from committing fraud, which they do not admit, which stops many of these operations, and then they go on into bankruptcy.

The four companies in the four incidents that I am talking about, is, first, the case of *Hall v. Security Planning*, which I am sure has been mentioned as A, B, C, or without identification in some of these hearings already.

It involved fraud, selling of both land and securities, over 9,000 contracts or deeds and mortgages and notes securing them were sold, whereas only 6,000 lots only actually existed.

Mortgages and notes were sold to approximately 3,000 people. The company involved was Cochise College Park, and it is currently involved in an action now. *Hall v. Security Planning* has been before the court since 1972, and bankruptcy B72-760 M, the matter of Cochise College Park, which is still before the court, both as an adversary proceeding and a bankruptcy. In this particular action over \$50 million—I mean, this is from the statement under oath by the promoters themselves, approximately 12,000 people scattered throughout the United States. It involved itself with the sale of Montezuma Lake, phony securities, Great Southwest, Prescott Valley, which I won't say they are phony, because they have made a settlement—and a number of others that were also involved in bankruptcies. Two of the people that were involved in these—three of the people that were involved in these two pieces of litigation, *Hall v. Security Planning* and the Cochise bankruptcy, are Messrs. Rivera and Tamuty, who were convicted of felonies by the Federal court here for their involvement, and a chap named Frahern, who was involved in a third bankruptcy. Now, I am involved in it, too, I represent some of the creditors, in the U.S. District Court for the Northern District of Ohio in the Eastern District, Bankruptcy B78-00428; B77-80048, see oil and gas funds. Lafayette Fund, B78-00430, which involves the sale of over \$40 million of limited partnership interests in oil and gas wells; they went into chapter 11.

Frahern, who is now under indictment in New Orleans—I can give you the case number, if you wish—I have the indictment here for his activities in the exploration matter, and he was a civil—we got a judgment, and when I say "we," I mean my plaintiffs and I, got a judgment against this man in his activities in selling the securities in the Cochise action. Rivera and Tamuty were also involved as well, in Co-

chise; Rivera and Tamuty not only were charged with fraud, but were convicted of it, felonies. Now I think that's organized crime. Now here we have cases in Ohio, cases—land fraud in Arizona involving the same people. Now, that takes care of three.

Now, let's go on to the fourth one, something called *Martin, et al., v. Cavanagh, et al.* I represent some of the fraud of people in the class action recently brought against the Cavanagh Community Properties, which is a Florida corporation formerly listed on the New York Stock Exchange, the principals of whom were interested not only in the Florida land development, which incidentally involved a number of what has heretofore been described, I think, as dummy corporations or shell corporations, have in our corporations, which was listed on the New York Stock Exchange, controlled wholly, and owned all of the stock in the following, plus more: Palm Beach Investment Properties, Vermont Land Corp., Wellington Orient, Miami Beach—remember Wellington Orient for the moment, if you will—Miami Beach Vacations, Universal Properties, Southwest Communities, Inc., Cape Hays Corp., Cape Cave Corp., Growth Properties, Prime Holdings, Ltd., Rotunda Development Corp., Cav Immunities Corp., Purdedo Bay Management Corp., Cavad, Inc., Rotunda West Utilities Corp., Rampart Development Corp., Old MacDonald Farms, Inc., Muhammed Produce Corp., Capagro Corp., Purdedo Operating Corp., Run Away Bay Properties.

And the company and other subsidiaries named in their Cavanagh titles were involved in a chapter 11 proceeding that ended December 13, 1976. The Wellington Co., in the particular suit that I'm involved in, sold out of one small—there was 20 developments going on at that time—they sold \$5 million worth of lots from property in Florida that was undeveloped at the time. In the sale of the corporation they complied with the HUD law.

Incidentally, while I am stopping here, I want to put this in evidence. I think somebody has a copy. This is almost identical to the same kind of crap, excuse me, that's used by Cochise and all of these other land frauds. One of their brochures, followed by a public offering statement filed by Weiman Atkins Investment Corp., prepared by Ash Lights Union One, comprising of 1,000 lots in something called Paradise—beautiful pictures of Paradise—it's an alligator farm and still is, which they sold at \$5,000 apiece, \$5,037.54. They promised the people not only in their agreement for a deed, but in their brochures, that they would complete the property, which was not improved at the time they bought it, but their commitment in their contract and in their brochures and in their HUD statement was: We will provide roads paved to county standards, utilities to your property line; all of these with no further costs.

Senator DeCONCINI. Had HUD approved that, by the way?

Mr. DUECK. I have got a letter I can show you, which I just received. I have all of their documentation.

[The letter referred to can be found in the appendix.]

Senator DeCONCINI. HUD did approve it?

Mr. DUECK. Yes; their approval, you know, doesn't say that they—you understand what their approval is.

Senator DeCONCINI. I understand.

Mr. DUECY. Excuse me for laughing.

Senator DECONCINI. It's a sad situation.

Mr. DUECY. Yes; I mean, it is a sad situation. But you can't blame those people, because they have a million of these coming in a year, and there is no way in the world they can police it.

At any rate, the same people that were promoting this were also involved in the Gulf American transaction, which involves one of our big frauds near Santa Cruz County, and in another one that involved the same people that were in Cochise that are near Bisbee in Cochise, and there were actions brought against them by the State of Arizona to stop them.

Now that shows that these same people that were involved in Florida, that were involved in Arizona, were the same people that were involved in all three different kinds of frauds in Cleveland. Now, they don't wear a button that says that I am a member of the Bonanno family, they don't carry an ID card, but if that's not organized crime, I am a damn fool, and I am no fool.

Now, having said that and established. I think, certainly the relationship of these four very small operations that I have in my office at this time, actively prosecuting, consider that a seven-man, with only four partners, a small firm in Scottsdale, Ariz., represents people involved in crimes in phony promotions, which of themselves total over \$500 million, and you can imagine what it is on the national scale.

Senator DECONCINI. For the record, Mr. Duecy, I think you're being a little modest; I think you are one of the most prominent lawyers in this field in the valley.

Mr. DUECY. I prefer to stay very anonymous in the field, if you don't mind.

Senator DECONCINI. I know you are not looking for any more business.

Mr. DUECY. Anyway, I don't think I can add anything more.

Senator DECONCINI. Let me ask a couple of things that you can help the committee with. We hear on many occasions that there is a problem with the administration of the bankruptcy laws, including the judiciary's appointments of the trustees. Please respond to that; is there evidence that there is some problem in our Federal bankruptcy procedures?

Mr. DUECY. Senator, if I may interrupt you, one of the things that really galls me is the abuse that our judiciary get. I have responded, at the request of judges who cannot defend themselves to countless hundreds of letters written by people who have been abused by these promoters, organized criminals, and they seem to feel that the judges are prosecutors, they are not; all the judge knows is what is presented to him.

I don't know. I know of some instances where I think judges are slow. But bear in mind my own prejudice, I am a plaintiff's attorney and many times things don't happen as I would like them to. I think that we have our problems with judges, they are only human beings, but I would like to make this comment at this time and in this place: It is that I think that the Federal judiciary in the State of Arizona is as good—and I have been around the country a good deal—as any judiciary in the United States, any district court.

Senator DECONCINI. Including the bankruptcy judges and magistrate?

Mr. DUECY. Yes, as far as honesty is concerned, but I don't say as far as ability is concerned.

Senator DECONCINI. Yes, I understand. I just wanted to get that on the record.

Second, with the involvement, Mr. Duecy, that you have had with this for a long period of time, you obviously could offer some suggestions, and if you would like some time to do that, or if you would like some time to do that for collective measures in the bankruptcy code—can you give us any quick fix or long fix for this problem?

Mr. DUECY. I think, Senator, I covered that very—

Senator DECONCINI. Is that in your memo?

Mr. DUECY. In my memo. And my suggestion, Senator, was not to really change any laws. And I think that—and I haven't been here all day—but I haven't heard anyone touch on the matter that my memorandum concerns itself most directly with, and that is with the Organized Crime Control Act of 1970. I think with very few changes in that act, and if I may take a moment, I would appreciate the opportunity in explaining this for those people that are listening or interested.

The Federal Organized Crime Control Act of 1970 was passed by Congress. In the statement of findings and purposes the Congress didn't mention specifically the bankruptcy situation, but in section 1, 1961 of the act, they did recognize the existence of the criminal activities in bankruptcy by saying that racketeering activities mean "A" something and then "B." I am quoting out of context, so anybody to understand it would have to read the whole thing. D: Any offense involving bankruptcy fraud, fraud in the sale of securities. Now, this really is what I have been involved in for the last 15 or 20 years deeply. And the act, further, in one of its very many provisions, provides that an investigator may be appointed under the direction or control of the Justice Department.

Now, as the law is presently drafted, this investigator's information that he develops is used primarily in bringing actions against the crooks, if I may use that term; let's be brutally frank about it. In criminal proceedings or otherwise injunctive proceedings which stop the dishonest promoters from continuing their dishonest actions, but they're not used in civil actions brought by private lawyers, nor can they, in the one exception and that's where the evidence that's developed is used in a successful criminal action by the United States. Even then, if it's a successful action, and I think the Senator will understand what I am talking about—

Senator DECONCINI. I understand.

Mr. DUECY. And the defendant pleads nolo contendere, which means: Sure, I will take the onus of the blame, but I really am not admitting anything. You cannot use that evidence or that admission of the evidence against him, so basically they use a chapter 11, or after they get stopped by an injunctive proceeding, which is a civil Federal proceeding, but doesn't represent the victims of the fraud. It says, "Stop doing this thing," but it doesn't punish them for what they are doing, so this investigator that I am speaking of, in his present status and present authority—and the information, again,

is not available to the private sector, people like myself. Now, I don't think it should be. That's a hell of a thing for me to say, but I don't think it should be.

We have a very peculiar situation. This investigator appointed by the Justice Department can represent the trustee in bankruptcy, because the trustee in bankruptcy is an officer of the court, and there is lots of law to support this, Senator. If the investigator develops enough information to support—I don't mean it's his idea, and I have recited in my memorandum some of the guidelines—if he can develop enough evidence to support an action by the bankrupt, whether it's a chapter 11, chapter 10, or a straight bankruptcy, to pursue this man or these men or the promoters to try to recover the millions of dollars before they ship it to Switzerland, Mexico, or wherever, and they do this, this is no joke. In that event, you would have something that we private practitioners cannot afford: an investigation in depth with the power of the bankruptcy court, because in the bankruptcy court the discovery procedures are tremendous, and they're even enhanced under the Federal Rules of Criminal Procedure, both of which would be available to the attorney representing the bankruptcy trustee under the supervision of the Justice Department. This person could develop and recommend to the Justice Department that a civil case for damages be brought on behalf of the debtor, so that the debtor would recover from the crooks that dumped it into this proceeding, the amount of money that they had defrauded the company from, I mean, the creditors, and then the bankruptcy could disburse the money to the creditors moreover, and this is an important thing.

If you do this, the director and the attorney could be paid out of the recovery; this is what we have in class action. I don't get anything unless I win an action and get a recovery. The same rule could apply to the Government investigator and the appointee of the Justice Department to pursue the action, only he would have a hundred times better availability to prove a case than I would.

I am not trying to talk myself out of any business, I don't need any, but I don't know how in the world, Senator, that the public can be protected against the use of the Bankruptcy Act by organized criminals unless the Government takes a firm step to make available to a competent attorney, and I mean one that knows what he's doing and can go over it and won't sit on it because it's a little difficult, to pursue these people before they get away with the money.

That's all I have to say. I hope I have explained it.

[The prepared statement of Mr. Duecy follows:]

PREPARED STATEMENT OF CHARLES DUECY

Starting in the 1920's and through the 1960's and thereafter the public became more aware of the fact that many facets of criminal activity starting with the unlawful trafficking in liquor, prohibition, prostitution, drugs, car theft, fencing, securities frauds, et cetera, required substantial unlawful areawide, nationwide or international organization to handle the illegal material, goods or services from its unlawful production to its ultimate user or consumer. The Congress of the United States in 1970 recognized the existence of organized crime in the United States by enactment of the Organized Crime Control Act of 1970.

For convenience the "Statement of Findings and Purpose" of the 91st Congress in enacting the law is set forth as follows:

"STATEMENT OF FINDINGS AND PURPOSE

"The Congress finds that (1) organized crime in the United States is a highly sophisticated, diversified, and widespread activity that annually drains billions of dollars from America's economy of unlawful conduct and the illegal use of force, fraud, and corruption; (2) organized crime derives a major portion of its power through money obtained from such illegal endeavors as syndicated gambling, loan sharking, the theft and fencing of property, the importation and distribution of narcotics and other dangerous drugs, and other forms of social exploitation; (3) this money and power are increasingly used to infiltrate and corrupt legitimate business and labor unions and to subvert and corrupt our democratic processes; (4) organized crime activities in the United States weaken the stability of the Nation's economic system, harm innocent investors and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens; and (5) *organized crime continues to grow because of defects in the evidence-gathering process of the law inhibiting the development of the legally admissible evidence necessary to bring criminal and other sanctions or remedies to bear on the unlawful activities of those engaged in organized crime and because the sanctions and remedies available to the Government are unnecessarily limited in scope and impact.*

"It is the purpose of this Act to seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process by establishing new penal prohibitions and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime." [Emphasis added.]

The attorneys who represent crime cartels or syndicates are actively working to subvert the law. The subornation of judges, prosecutors, legislators, and other court or governmental officers is an important part of the criminal activity of the syndicate.

The congressional "Statement of Findings and Purpose" does not specifically mention the use of the bankruptcy by organized crime. That does not imply that the problem was overlooked or did not exist at the time of enactment of the Organized Crime Control Act of 1970.

The problem, among others, was specifically dealt with by the provisions of title IX of the act. For the convenience of the staff a xerox copy of title IX of the act is attached (18 U.S.C. sections 1961 through 1968).

Particular attention is directed to § 1961 (1) (A), Definitions, which as used in the context of the Act provides:

"(1) 'Racketeering activity' means (A)—(D) any offense involving bankruptcy fraud, fraud in the sale of securities, or \* \* \*"

Subsections (3), (5), (7), (8), (9) and (10) of § 1961 define the fundamentals of racketeering activity, the investigative personnel and requirements to bring an activity within the scope of the act.

Section 1962 describes activities prohibited by the act and sections 1963 and 1964 describe the criminal (§ 1963) and civil (§ 1964) penalties.

The Government's civil remedies are generally speaking limited to obtaining injunctive orders. Civil remedies for the victims of the fraud are relegated to private civil actions (see subsection (c) of § 1964) and may only benefit from results of the Government's action if the action by the Government was a criminal action and resulted in a final decree in favor of the Government. The Government departments generally settle with a consent decree in a civil procedure.

In view of the Government's recognition of the problem (Organized Criminal Activity in Bankruptcy Proceedings), it should not be necessary to elaborate on that issue. However, a few short remarks are appropriate.

In this writer's limited experience several basic facts have developed. The cases generally involve hundreds or thousands of small investors or purchasers who are mulcted in a common pattern of fraud. In our experience the fraudulent activities have been generally securities frauds, land frauds, pyramid schemes, financing schemes, merchandizing, and inventory frauds.

The evidence that the activity is organized is the reoccurrence of the names of individuals who participate in a number of different and widely scattered fraudulent activities, the use of identical or remarkably similar documents, brochures, procedures, mailing lists, and the final resort to bankruptcy when suits are filed. The Government can get this data under section 1968 of title IX.

The Bankruptcy Proceeding most generally used (under the Old Bankruptcy Act), was the chapter XI device staying virtually all suits against the bankrupt and letting the fraudulent promoters remain in control.

Straight bankruptcy under chapters I through VII were the second choice of the fraudulent promoter (depending on the particular circumstances). Chapter X was only resorted to if the promoter couldn't hold it at an XI, or in rare cases where, because of an inept or poor referee (bankruptcy judge) or a pattern of venal or tame trustees, a chapter X would serve to delay, confuse and frustrate the victims of the fraud as well as a chapter XI proceeding.

In our limited experiences starting in the 1960's with the 8 percent Hospital Bond Frauds through to date with current pending actions involving sale of interest in oil and gas developments, sale of unimproved lots as improved lots, sale of notes and mortgages, we can account for well over \$500 million as a minimum that has been taken from victims for whom we have sought civil recovery. This represents only the tip of the iceberg. Our personal experience is confined to a small number of the total frauds.

In virtually all the cases we handled the Government through the SEC, the FTC or HUD or other agencies were involved as well as the State under the Consumers Fraud Laws and other State laws.

In all but a few cases handled by our Arizona district attorney, the promoters settled their problems with the SEC, FTC, HUD or other agency by a consent decree.

The Arizona district attorney has been the exception and has brought criminal actions against the promoters.

In our cases, mostly class actions, we have corresponded with thousands of victims of frauds and have a pretty broad comprehension of the characteristic victim. Unfortunately and almost without exception the victims believe that the court (bankruptcy and civil judges) have investigative and prosecutorial powers. We have had scores of letters referred to us by judges in matters we handled requesting us to respond to fraud victims' letters, some pretty nasty, inquiring as to why the judge didn't do things that are not in the court's province or jurisdiction. Most of the letters were directed to instances where the real prosecutors or investigators have failed. This should be remedied!

This writer's views on possible remedies to the problem as he sees it must be considered from the standpoint of the prejudices and frustrations that a plaintiffs' attorney comes by naturally.

First: A plaintiffs' attorney's primary interest is making his client or clients whole financially whereas the Government is primarily concerned with stopping the unlawful activity and punishing the guilty parties if they are criminally involved. Recovery on behalf of a victim is not a part of the Government's task, or if it is, it is secondary.

Second: In the massive frauds which are brought into bankruptcy courts, frequently after a consent decree in a Government action that stops the unlawful fraud, the bankrupt debtor is, as a practical matter, a no-asset case. The thousands of victims of the fraud have neither the money nor the ability to investigate the principal promoters of the fraud or attempt to trace and recover the millions of dollars that were siphoned off by the promoters. (Under section 1968 the Attorney General can.)

In effect the Government's action has closed the door to the barn after the horse was gone. The promoter keeps his unlawful profits and the victims have no valid recourse to attempt recovery of their damages and can't investigate the fraud as the Attorney General can.

The promoter goes on to another fraudulent promotion.

There is at present no practical means of accomplishing the Government's ends and also providing a fair opportunity for the fraud victims to pursue their remedies or even to use the information developed by the Government to stop the fraud.

How can Congress remedy the inequity created by the fraudulent use of the Bankruptcy Act?

As a beginning, the Organized Crime Control Act, which is the best vehicle to date to fight organized crime, could be further amended to benefit the victims of the promoters who use the Bankruptcy Act to further their fraud.

A provision could be incorporated into the act that would require a special investigator (as defined in title 18 U.S.C. sections 1961 (7) and (8) to investigate any bankruptcy involving a large number (say 100 or more) of claims

arising out of identical or similar transactions with the bankrupt debtor if the total of the claims is in excess of a specified amount (say \$200,000).

An additional provision should provide for an investigation by a special investigator when request for such an investigation is made by the bankruptcy judge, the trustee or receiver, a debtor-in-possession, the creditors' committee or three or more creditors whose claims exceed \$15,000 in total.

A provision could be incorporated into the act that would establish accounting and computer facilities for the Justice Department, through the Attorney General's Office, to audit the records of suspect bankrupts; a provision could be made that would provide that the names of all persons who controlled or participated in the pre-bankruptcy management of the bankrupt would be placed in a master list (probably computerized) kept by the Attorney General's Office and checked to determine if any of the controlling persons were similarly involved in other bankruptcies.

The special investigator should report and recommend to the Attorney General if there is any evidence of fraud and organized criminal activity in any bankruptcy investigated. If such evidence is developed, a special prosecutor, experienced in this field of fraud, should be appointed to bring an appropriate criminal action against the alleged perpetrators of the fraud.

A provision of the act could be incorporated that would provide that the special prosecutor would be appointed as special counsel for the bankrupt estate to bring and prosecute a civil action on behalf of the bankrupt estate against the fraudulent promoters, concurrently with the criminal action, and such to recover for the estate all funds fraudulently obtained from creditors so the bankrupt estate could disburse the funds to creditors in settlement of their claims after first reimbursing the Government for its costs. (Evidence obtained under section 1968 must be available for this litigation).

All too frequently in the past the debtor-in-possession or a trustee, if one is appointed, will not bring an action against the fraudulent promoters. The debtor-in-possession usually because he is involved, and the trustee either because the estate has no funds, he is incompetent or is controlled or influenced by the promoters.

A provision of the act should provide that all statutes of limitations are tolled during bankruptcy and during any period that a fraudulent promoter acted to conceal his fraud.

I trust the foregoing data and comments will be of help to the staff and committee at the scheduled hearing of January 11, 1979.

I will be pleased to respond to questions or elaborate on the foregoing at the pleasure of the staff or committee.

Senator DeCONCINI. You have. Your explanation is very good. In the reform of the Bankruptcy Code we did last year, we addressed it, but not to the extent you have mentioned. I shall pass along your comments to other members of the committee.

I want to thank you very much, Mr. Duecy, for your constant help to this committee, not only today, but other times that you have sent us information. We appreciate you taking the time.

We will take a 10 minute recess.

[Whereupon, a recess was taken.]

Senator DeCONCINI. The subcommittee will come to order. Our next witness is Ron Lebowitz. We are very pleased to have you here.

#### STATEMENT OF RON LEBOWITZ, ATTORNEY, PHOENIX

Mr. LEBOWITZ. Thank you, Senator.

First, I would like to thank the subcommittee for inviting me to appear. I have not come with any prepared statement. I thought for the sake of expediency and economy of time, I would be happy to answer any questions that the subcommittee may have to ask.

I should point out that I suppose one of the reasons why I was asked to appear here is because of the fact that I have had about 10

years experience in prosecution in various capacities in Arizona and elsewhere, and about the last half of my career as a prosecutor dealt with white-collar crimes, not only in the area of frauds connected with land, as has been discussed during the time I have been present this afternoon, but in other areas as well.

Senator DECONCINI. Were you the prosecutor in the *Lincoln Thrift* case for the attorney general's office?

Mr. LEBOWITZ. Yes, for the attorney general's office.

Senator DECONCINI. Is that case still on appeal? Can you discuss that case?

Mr. LEBOWITZ. It's on appeal. The appeal has been argued already before the court of appeals, and a decision is still pending; however, I have no restrictions upon me since I have been in private practice.

Senator DECONCINI. Can you give us a little background, for the record? I know a little bit about the case, and I have read the memos that you have given to people before and some of the attorneys involved, but if you can give us a couple of minutes of background and exactly what did happen.

Mr. LEBOWITZ. All right. From my point of view I first became familiar with problems with respect to *Lincoln Thrift* when I joined the attorney general's office under the administration of Bruce Babbitt in the fall of 1975. The then attorney general, Babbitt, had received information that the books and records of the company contained some irregularities, and it was at that point that one thing was discovered, and that is and has been a critical problem in the State of Arizona, namely, in the regulatory area; that is, that *Lincoln Thrift Association* up until that point had never really been thoroughly audited by any qualified people.

The attorney general's office discovered that the corporation commission had done its best with the staff that it had available to it. However, it should be kept in mind that at the time that *Lincoln Thrift* was actively operating, the securities division of the corporation commission did not have an accountant; they had the people who would go out and conduct what were called annual audits, and didn't have the capacity or capability of examining books and records with an accountant.

In fact, it was our discovery that essentially—the only thing they would verify is whether or not the columns to the books added up. In other words, were there any mathematical errors; they were unable to discern whether any line items within the books were valid or if they meant anything, if they had any documentation to back them up.

The attorney general along with the corporation commission decided to draw upon professional service funds to employ Arthur Anderson to go in and take a full audit of *Lincoln Thrift*. It was at that time that the audit of Arthur Anderson revealed that that company was in severe financial condition. When I say "severe financial condition," I am talking about such things as, for example, the creation on the books of assets that did not exist. And not only did they not exist as recognized assets under generally accepted accounting principles, but they were, in fact, liabilities, costs of doing business that were capitalized.

One typical example was that there was an entry under the books called "Branch Offices," and the term was somewhat vague and am-

biguous, and someone who would look at it might think branch offices—think there was a lot of branch offices, property that *Lincoln Thrift* owned, and nothing could be further from the truth, because all the branch offices, with little exception, were leased, they were not the property of *Lincoln Thrift*. What was included within that category were salary for branch office employees, utility bills that were paid, such as telephone, lights, heating, cost of leasing furniture, costs of leasing business equipment, et cetera.

*Lincoln Thrift* grew to the point that what looked like an asset worth several million dollars was really worth nothing, and if it had been placed on the property side of the balance sheet, it would have shown from the beginning that *Lincoln Thrift* was in the red.

And when I say *Lincoln Thrift*, I should also point out that I am talking about a sister company called U.S. Thrift, and there was a third company that almost no one ever heard of called American Thrift, which was located, supposedly, in Scottsdale and Tempe.

The operation was such that money was supposedly, or at least assumed, to be deposited by people, people who are unaware of the fact that under the laws of the State of Arizona people who would put money into a thrift company were classified as investors, not depositors. The thrift company did everything it could to make itself appear to be a savings and loan, and yet it was not.

In fact, it was not insured by any Federal insurance company such as the Federal Savings and Loan Insurance Corporation, so the investors really had no protection in terms of insurance, other than by the ostensible protection of insurance companies that were subsidiaries of *Lincoln Thrift* and U.S. Thrift.

The problem with a thrift company being insured by a company that it wholly owns, is that if the thrift company goes under, so does the insurance company, and so it was really nothing more than a false facade; nobody's accounts were insured.

In fact, the other problem was that there were a great number of corporations that were created that were affiliates or subsidiaries of the thrift companies, most of which did not perform any discernible function that would make the creation and the operation of such companies prudent from a business point of view. For example, the head of *Lincoln Thrift*, who was commonly known as being Robert Fendler, as the evidence came out, did not believe, for reasons of his own, that any other businesses in Phoenix, for example, would do business with him or with *Lincoln Thrift*, and therefore he found it necessary to create his own printing company, own interior decorating company, own furniture company, et cetera. From a business point of view this was about as unsound as could be, because none of these companies had any outside source of business, they did business only with the thrift companies, and the bills they charged the thrift companies were vastly inflated, it was difficult to determine how much money at any one time was being funneled out of the thrift companies and into these other companies, and how it was being spent. To this day that question cannot be answered, because the records are so farcical.

A lot of this might have been detected or at least the tip of the iceberg might have been detected if there had been more thorough regulation by the corporation commission, but I cannot fault them entirely, because they were not very well staffed by the legislature, and perhaps

they were the outgrowth of a climate in Arizona that did not require that kind of vigorous regulation 20 or 30 years ago.

A part of the problem is that Arizona has become a far more sophisticated and a far more heavily populated State, and Lincoln Thrift was typical of fraud operations anywhere in Arizona, because when you have a State that has a large segment of its population that consists of people who are on pensions, who are retired, who are living in the midst of an inflationary spiral, and who desire to somehow create and generate additional income so they can keep pace with inflation, they may get impatient, by nature, and wish to find something where they can get as large a return on their investment as possible. Unfortunately, that is the kind of climate, when coupled with a not terribly rigorous regulation structure in the State, that is very appealing to people who wish to commit fraud.

Now, what happened in Lincoln Thrift was simply that the money was dissipated; ostensibly the money that was invested by people was to be used primarily for the creation of medical and dental leases. We studied the lease program of the thrift companies and discovered certain interesting things, and it's sort of noteworthy that we are talking about bankruptcy here.

Almost every person who was a doctor or dentist who received these loans had just experienced bankruptcy himself. Now, the defense in that case argued that, therefore, that made them extremely good loan risks, because everybody knows you can't go into bankruptcy for another 6 years.

I should point out that a tremendous number of the leases that were written were never paid, and the response that the defense raised to that was: Well, we went to court and we got a judgment on all those leases that went into default. What we were unwilling to admit, but under fairly strong pressure on cross-examination did admit, was that none of those judgments were ever satisfied. But it doesn't answer the question, because there weren't that many leases to account for, about \$23 or \$24 million out of \$53 million invested that was totally unaccounted for, and that will always be somewhat of an open question: What has happened to that money?

The records that the company kept were not adequate to trace it all, and we don't know what happened to it, and we don't know what other outside interests there may have been in that thrift company aside from the individuals who were the principals and were prosecuted.

Senator DeCONCINI. And convicted; is that right?

Mr. LEBOWITZ. And convicted. I should point out that the State, because of other problems that are typical of our system today, found it necessary rather than to prosecute the entire spectrum of activities that occurred in Lincoln Thrift, to concentrate on what was then a seemingly narrow transaction, so that a good prosecution that was solid could be presented and convictions could be obtained.

I don't think the State was quite aware of the fact that that somewhat narrow prosecution would last 5 months long in court and turn out to be the longest criminal trial ever held in the State of Arizona; however, it does give some example of the enormity of the problem.

I should also point out that there is currently a case which is in the Federal district court against some of the same principals, and that case

was investigated by the U.S. attorney, the FBI, and I would assume, quite probably, the Postal and SEC, and that has focused more strongly on the fraud aspects than our focus was. What we focused on primarily was the one limited transaction that a bank, a federally insured bank was out of funds that originated from Lincoln Thrift, and although it was the investors' money that created that bank, none of the investors had any stock in the bank.

The bank was the American Bank of Commerce in Phoenix, which has since been sold, and none of those individuals who were then involved in the bank are connected with the American Bank of Commerce today. But it was a good microcosmic example of the kinds of activities that were going on, and that's why we selected it.

The reason why we found it necessary to be very precise in the scope of our prosecution is a classic problem that exists in Arizona today. In the attorney general's office we had qualified attorneys to prosecute the case and work on the investigation, however, we did not have qualified investigators. There was virtually no one in this State, on the State level, that was able to comprehend the sophistication of this case and work on a criminal investigation, and we certainly tried.

Senator DeCONCINI. Do you still think that is true today?

Mr. LEBOWITZ. I don't know, but I would say that it has not improved to the level that if they had tackled that case, they can do it successfully. Still, I think it's getting better, but I don't think we have reached a successful situation yet. In fact, it took four attorneys to investigate that case, and it got to the point it was just necessary—let's forget the law enforcement agencies, because they're not ever going to get it off the ground. Four qualified attorneys worked on it entirely, and that's a very expensive process when you have to take up the time of four attorneys to do nothing more than that for a year and a half. You are talking about an attorney's time, times four, for a year and a half. We were successful in reaching that result, because it was a good case and it certainly withstood the test of combat in court, but nobody else could have done it, unfortunately, at that time.

There are problems that exist in the State still on this, and I don't say that it's something that you can fault the police directly on, because the law enforcement is just like the public itself, it operates in a reactive mode. You cannot sit back and beef up a law enforcement agency in anticipation on something that occurred. It takes years to catch up, and I think that what is required is good and vigorous recruiting of people experienced in the field to teach others who are already in law enforcement.

I think the whole nature of a fraud case requires a different kind of thinking than the average police officer is used to dealing with. This is not the kind of situation where something occurs on the street, it is a once only offense: You see it, you make an arrest, and you pull the person in.

Fraud cases are traditionally very slow in developing, and require a lot of time and patience. It does not have the glamor, as far as the investigator is concerned, of going out on the street and finding someone who is a killer, but I think it's more serious than the average murder. The reasons why I feel that successful fraud is more successful than the average murder are (1) the average murderer, as statistics will bear out, is not a well-educated individual, and very often com-

mits that murder for reasons that are not for personal gain, monetarily; (2) in the average fraud case you are dealing not with just one victim, an event that occurred one time, one day. In this particular case where we're dealing with 23,000 victims in the State of Arizona alone; (3) the person that is committing the fraud is generally pretty well educated, articulate, is working on a very carefully conceived plan, and from the first day that he is committing his fraud, he is constantly thinking about how he is going to cover his tracks. If he is smart about it, he certain knows he will be caught. He makes a good witness in court, he is usually a good salesman to a jury. Fortunately for me, I am pleased to say that I have seen that mentality, because sometimes they get a little overconfident, and that's where they can convict themselves in front of the jury. However, they are very hard cases, they are long cases to prosecute.

As I said, Robert Fendler, Lincoln Thrift, lasted 5 months and during that I worked continuously; it was the only way that the case could be won. Because unless we stayed—I mean, it wasn't just a question of walking into court, doing your thing for the day, then going home. We would walk into court and leave, and we would stay back in the office examining everything that had been said and how to readjust our position on it and answer it, and we would stay there until 12, 1 every morning, and that's the kind of effort that is very difficult, I submit, to get at a constant level from anybody, especially when you know, to be very frank about it, the pay isn't that good.

I was in a very unusual situation, because I had already left the office and I was in private practice; I was brought back on a contract, so I can't complain about the attorney's fees. But none of the other people I worked with were in that situation, yet they were all very dedicated, they all worked very hard.

I don't think the public realizes how hard it is to successfully prosecute such a case, so that's another problem. You have to get good, dedicated prosecutors, and if you want to tackle this problem in a sensible way, you have to do it in large numbers.

Senator DECONCINI. Does it, in your opinion, make some sense to try to contract out for that service rather than trying to bill it within the organization?

Mr. LEBOWITZ. Oh, I think you can do both. Very simply, the reason I was contracted to try this case was, again, it was a question of availability. There were other attorneys in the attorney general's office who could try the case, and one of them was Bill Shaefer, but it just so happened that at that time he was trying the *Bolles* case, and they were involved in that effort, so at that point the office was caught short as far as real depth of long time trial experience. And as I am sure you are aware, because I know you were once a county attorney, it's hard to get a great number of prosecutors who have many, many years of experience to stay, and there is a certain turnover rate in any prosecutor's office, and that's a problem. I will say this much: The idea of contract prosecution is very attractive.

Senator DECONCINI. For such cases, sophisticated cases as this?

Mr. LEBOWITZ. I would have loved to go back and help the U.S. attorney on the second leg of the Lincoln Thrift prosecution because of my background in it, but there is one other problem that exists in

white-collar prosecution, and it is not a question, I believe, of corruption or cynicism or anything like this. The average judge, whether it be State or Federal, who deals with a lot of criminal cases, has to pass sentence on people all the time, and over the years he looks at certain standards on which to determine if the person should be sentenced or should be placed on probation, and if the person is rehabilitated he looks at the person's education, he looks to see if the person is gainfully employed or capable of getting a job, and looks to see whether or not the person has people in the community who will come forward and speak on his behalf. And if all those things are negative, including if he has a prior criminal background that is extensive, and whether or not the crime was a crime of violence, and if he is going to be a danger to the community as far as being a threat or force of violence on other potential victims, that individual who fits that profile is going to go to prison.

All of those principles and all of those guidelines that apply to a street crime are just the reverse in a fraud case. The average person who is guilty of fraud is generally well educated. Mr. Fendler, let's take for an example, graduated from Pomona College, Southern California School of Law; he was a practicing attorney, admitted to the bar in California, and his parents were prominent attorneys in California, both practicing out of Beverly Hills. So you have a background that under normal standards to say: Well, this person comes from a fine background, well educated. He made a mistake but can be rehabilitated. If that was a crime of violence, maybe you can say that; but you can't say that in a fraud.

Second of all, a person who conducts a long-term fraud or who suddenly takes whatever position he may have legitimately received and converts it into a fraud has worked a long time in becoming well respected and received within his community. Otherwise he is not going to be successful as far as the conduct of fraud is concerned. This may be the kind of person who is well thought of in his church. He may be involved in various charitable societies; he may have all the credentials that look good, and I might also add that he may be the kind of person that supports a political party, and who everybody likes, and he may be very popular.

Senator DECONCINI. He may serve on boards of directorship and hospital boards?

Mr. LEBOWITZ. That's correct; many of those types of things. And when he is convicted, all those people who are themselves prominent and honest people will rise up and write a letter to the judge to say what a good person this individual was.

Senator DECONCINI. Some of them may really believe it; wouldn't you say?

Mr. LEBOWITZ. That's right, because they didn't deal with him in this narrow aspect of his activities. And all of those things are going to influence the court, and it's hard to say to a judge: No; you are forbidden from considering all these things that you consider otherwise. But it's got to be looked at in its perspective, and I don't know that the message still has been sent out to the judiciary that there are other things that have to be looked at, like how many people were victimized, how badly did this person get hurt.

Senator DeCONCINI. What was the sentence?

Mr. LEBOWITZ. He got 4 to 5 years. He is currently on bail pending the appeal.

Senator DeCONCINI. How many counts was he convicted of do you remember?

Mr. LEBOWITZ. He was convicted at the end of two; he could serve 20 years, maximum.

Senator DeCONCINI. So he could be out in as few as 22 months couldn't he?

Mr. LEBOWITZ. That's correct. I think it's going to be a long time before the appellate process returns its course, assuming it's successful all the way, and I am hopeful it will be, but when you consider that a part of that missing \$23 million has been privately secreted somewhere, 22 months is not a bad risk.

Senator DeCONCINI. Maybe it depends on where he serves it.

Mr. LEBOWITZ. However, once again, even that comes back to haunt you, because it's not a crime of violence, so some will go to a minimum security rather than a maximum security institution.

Senator DeCONCINI. Mr. Lebowitz, in your experience do you have any suggestions concerning the bankruptcy laws?

Mr. LEBOWITZ. Well, part of the problem with the bankruptcy situation is that as long as we are going to exist in our present form of government with our present constitutional guarantees, I don't know that there is that much that can be done, because the alternative, which I don't think our system of government is willing to accept, is to say: We are going to close the door of bankruptcy to you and you are not going to get out of this by filing bankruptcy. But people have a constitutional right to accessibility to the courts, and I don't think you can take that away from them.

As I understand, there have been some restrictions that have been placed on the immunity restrictions of the Bankruptcy Code, but I don't know that there should be any immunity unless there is something that involves a prospective prosecution.

It bothered me considerably when I first got to Arizona and I worked on bankruptcy cases, there was a pretty wide open immunity statute, and anybody could get in and say anything he wanted to when he got immunity, then it got chipped away a little as a result of the *Castagard* decision of the Supreme Court. But still, that to me, was very disturbing, and its disturbing because bankruptcy, by and large, especially as these companies are involved, is a procedure that a fraudulent operator wants to get involved in ultimately. It is the last step to the company's graveyard, and it is something he chooses to seek, and therefore I don't see how or why he should be given the benefit of any immunity whatsoever.

As far as the maintenance of the bankruptcy court, as I have heard there have been some complaints regarding trustees, et cetera, but I think that's something that is an institutional thing, and I don't know if the changing of a law is going to make for more competent or honest trustees. I don't think you can legislate that; it is a very difficult thing.

I don't know that a change in the Bankruptcy Code is going to resolve the problem; I think what is going to resolve the problem is more effective means of detection, regulation, and—

Senator DeCONCINI. For example?

Mr. LEBOWITZ. Regulations first, because, as I am sure you have experienced, the bankruptcy court is, very often, how people learn they have—

Senator DeCONCINI. Do you concur with some of the testimony today, including the attorney general, that there is a need to have more sophisticated investigative staff, accountants, et cetera?

Mr. LEBOWITZ. Absolutely. I will tell you what else there is a need for. There is a much greater need for cooperation among law enforcement agencies, and for these institutional rivalries that exist, too.

Senator DeCONCINI. Did you find that to be the case in the *Lincoln Thrift* case?

Mr. LEBOWITZ. Terribly so.

Senator DeCONCINI. Can you give us any examples?

Mr. LEBOWITZ. Well, there have been institutional rivalries amongst, first of all, Federal and State. The police deal with, for example, the Federal Bureau of Investigation, but when you take a look at how they have investigated a case, and because I have experienced this personally, the last thing they want to hear is the FBI would do this more thoroughly; that is the worst thing they can be reminded of.

I spent 5½ years in the Federal system as a prosecutor, and I found a group of agencies that were far more responsive, especially in this area: The Postal Inspectors, the FBI, the Securities and Exchange Commission, and when required, the Criminal Intelligence Division of the Internal Revenue Service. If I, as a prosecutor, said to them, "I want you to do something," there was usually not a great argument about it, they would do it. And I think, perhaps, they did it because it is all one level of political subdivision, it is all Federal, and that makes them more responsive.

Prosecutors, I think traditionally have a problem with police departments. County attorneys are in county government, police departments are in city government, and if the push comes to shove and the county attorney wants to force a police department to do something that they're too slow upon doing, he doesn't have the power that he should. If a U.S. attorney wants to force somebody to do something, he writes to the Justice Department in Washington, and the FBI is still a part of the Justice Department, and they are going to be more responsive. If it requires the Attorney General of the United States to get it done, that can't be done on State and local levels.

Unfortunately, in the State it's been my experience in the department of public safety—I wish that there were a copy or a model of a Justice Department in Washington to put DPS under Attorney General, so that when something has to be done, and done in a short period of time, if need be, it can be ordered and not just asked for.

Senator DeCONCINI. More accountability?

Mr. LEBOWITZ. That's right. And the same thing is true with the police department. It was my experience that the police department would come in with their report, which is commonly referred to as a DR, and I would review it and say that this is fine as far as it's gone, but we need more investigation; that was something I was accustomed to in the Federal system, and I ran into roadblocks I had never experienced. It was if I was being presented with a great work of Amer-

ican literature which was impossible to improve upon, and there were many times I ran into a "This is it, take it or leave it situation." Well, white-collar crime cannot be prosecuted on a single visit to the prosecutor—

Senator DECONCINI. The prosecutor has to begin very early?

Mr. LEBOWITZ. Not only begin early, but the acceptance does not mean the investigation is over. Investigation on a case like that normally continues right through the trial, because, let's face it—

Senator DECONCINI. The prosecutor, would you agree, should have control over the investigation, as far as directing what should be investigated?

Mr. LEBOWITZ. Absolutely. And I think prosecutors don't work together as well as they should. I think county and State should work much more closely together than it does. I think there should be a total disregard of who gets credit for what, and if that is the concern, there should be combined prosecutions so everybody gets credit, because the only person who is the beneficiary of this is the criminal.

Senator DECONCINI. Thank you very much. We appreciate the time that you have taken from your practice to be here today. Your testimony has been very helpful, and we may call on you again for some other hearings we are going to conduct later in the year.

Mr. LEBOWITZ. Thank you very much.

**STATEMENTS OF PROF. LEON BEENE AND FRANCES BRUNNER,  
REPRESENTING MONTEZUMA VESTED RIGHTS, INC.**

Senator DECONCINI. Our next witnesses will be Prof. Leon Beene, and Frances Brunner representing the Montezuma Vested Rights, Inc.

Mr. Beene, would you like to lead off with the overview, or however you prefer to—

Mr. BEENE. That would be fine, Senator. I know we have been here a long time, so I will make them brief. There have been a lot of important comments.

There are a couple of things I would like to touch upon, and one is that the Arizona climate has been very important in the crime in this State, and one way is that a lot of people who are moving into Arizona are principally concerned with the economy, and this makes it very easy, because the mentality of the State, historically, has been one of lack of regulation. Now that can work both ways. It can be very good for the businessman, but it can also be very good for the organized criminal who can take advantage of the loose regulatory laws.

Now it is true that in the recent years we have beefed up our regulatory system, but there is a prevailing philosophy to that; if you are successful in business, then you become successful and ease into other elements of society.

I used to say, facetiously, that if you wanted to take a look at the crook, take a look at the social page. Well, that is facetious, but there is an element of truth in it. But if you would take a look at Ned Warren's past activities, he would be in the receiving line of politicians and he would be on the social pages of the newspaper, and it really wasn't

until 1972, although Don Bolles had written the article in 1967 or 1968 on him, that he had to curtail his activities, because it became such a liability to a lot of his other contacts.

If Warren was able to move with ease, shall we say, into the upper line of, certainly, the business element, how many other people are moving in that element also who have fraudulent activities?

Now, the thing that has bothered me from my research is—and I have looked at a number of fraudulent land companies in both the bankruptcy records and the court records of what has happened and transpired with these individuals—the names that I see, that constantly reappear associated with the bankruptcy corporations, land fraud corporations. I don't want to poke guilt or anything at one element in the society, but, for example, there are some very prosperous attorneys in Arizona who are still practicing today that have had a very close association with a lot of fraudulent activities and bankrupt companies in Arizona.

Senator DECONCINI. You mean other than representing them?

Mr. BEENE. Other than representing them on the board, statutory agents, things like this. It was brought up this morning that what land fraud was, was just a vehicle to create a cash flow. You can take the same methodology and establish a fraud in many other areas. Well, land fraud happens to be one of the early areas, and diamonds came later. If you would take a look at the people who operated in the diamond frauds, they had real estate licenses, they had been involved. In fact, there was one attorney who was a statutory agent for some of the fraudulent land companies who happened to be a statutory agent for a diamond company that was, at least, publicized in the newspaper, and there was an investigation on that company. This is the thing that bothers me.

There is another thing that bothers me and this is the massive effort that it takes to investigate and prosecute these cases. These large fraudulent cases are overwhelming. The average citizen does not realize the hours and years, literally, that goes into the investigation.

Well, let's say that you bring this all the way through successfully, you have a successful investigation, you have a successful prosecution here, then it comes up, and now the ultimate person in the process becomes the judge, who must pass sentence. Well, if you would take a look at the people who have been fed into the judicial system and who have been prosecuted on crimes such as land fraud crimes and take a look at the sentence—in many instances I feel it's a disgrace, because Mr. Duecy, when he was here earlier, mentioned two individuals connected with Cochise College Park. These individuals were investigated, they were prosecuted, they were convicted, and when it came time to sentence, they were given probation.

Two of those individuals in 1971 were making \$400,000 apiece, and another individual that was convicted in connection with that had been disbarred as an attorney in Oregon, and had been indicted at least once, if not twice, on prior cases, and he was convicted, and he was also given probation. I think it is exactly for what Mr. Lebowitz said—they are educated, they are well-dressed, they are articulate individuals. And I do not believe that our justice system, at least our judges, realize that while they may have all the sophisticated articu-

lation of the educated individual, that at the same time they are hardened criminals that are dedicated to their tasks, and you can see that they have established one corporation after another. They have taken these corporations into bankruptcy, and ultimately when they are eventually—and only a very few eventually—convicted or even indicted of a crime, they are free to walk out on the street. Those unfortunate individuals who are put in prison, if you want to call them unfortunate, most of their sentences were very minimal sentences. And it is true what Mr. Lebowitz said: "They will serve their time in Springfield or some place like this, and not years, but in months they will be back out on the street."

There is one case here in which two individuals in a land fraud case pled guilty to felony counts, and that later were permitted to withdraw that guilty plea, and they were off free, and they are walking around to this day, after pleading guilty to a felony count.

Senator DECONCINI. Were those Federal cases?

Mr. BEENE. These are Federal cases.

Senator DECONCINI. Do you care to identify the two?

Mr. BEENE. No. This is the type of justice that I have seen here in Arizona.

Senator DECONCINI. Do you have any reason to believe it's any different anyplace else?

Mr. BEENE. No; I do not. All I can speak from is my experience from the research I have done in Arizona.

Senator DECONCINI. The research. Is it true in the State courts, as well as Federal courts?

Mr. BEENE. Most of my investigation came through the—

Senator DECONCINI. Do you have any studies or anything that you could let the committee have, that is not of a confidential nature, that lays some of this out?

Mr. BEENE. When I worked for the State legislature, I did a study pointing out some of the problems, a number of years ago. If it is valuable, they are certainly welcome to it, but I would need to look at it.

Senator DECONCINI. Fine.

Mr. BEENE. Now, there are two things I would suggest, if not repeat, is that bankruptcies are very complex, and they are very much a part of the overall—I mean, you can see it, like the corporations established that have been brought so far, and it is just a chain reaction here.

I think a lot of times the corporations that went bankrupt, their principals were involved in, at least, suggesting trustees to become the trustees once the corporation entered bankruptcy or reorganization, which I believe is chapter 11. I think that you need a very special type of trustee, one who is not only concerned with the problems of seeing that the corporation can be saved or how much the investigators can be protected, but also one who has an expertise, looking into the record to see if there is a fraud, in fact, that has taken place, and if there has been criminal activity and, thus, he can request an investigation in detail.

I would suggest for special corporations that enter bankruptcy, that there is a special trustee appointed for them. Something else I

would suggest on a larger scale, while the newspapers have been very great at publicizing the massive frauds here, and I don't think it's completely gotten across to the public, that organized crime costs each and every individual. And where I think this committee could be of a big benefit there is that some way the American public is alerted that this is dollars out of your pockets. There is a feeling that if somebody gets taken in a land fraud, that it's only one individual, but these fraudulent land activities in Arizona, for example, create higher taxes, because they had to pick up after the aftermath.

A small example is, if a subdivision was developed out here, and a couple of families moved out here, then the school system has to provide a bus to pick up those children, and to bring them to school, county roads have to be maintained. I do not think the public is aware of the cost to each individual. Organized crime costs.

Thank you.

Senator DECONCINI. Thank you very much. We appreciate that observation. Obviously, you have done a lot of study on the subject matter, and we would welcome any information you care to share with us on your ultimate findings when you have completed it.

Mrs. Brunner, we are pleased to see you here today. We hear from you often, and we know of your plight and those who you represent.

Mrs. BRUNNER. On behalf of our organization, I want to thank you for having these hearings; they will be very pleased. We have a thousand members, approximately, from 33 States, Japan, and Canada. They consist of people who purchased property at Lake Montezuma before the bankrupt companies came in—people who bought lots, and a few people—we are getting more and more of those in the last few, in this last year of the assignees, some who were swindled and don't have any—a fraudulent contract, and others who have waited years to have their money released from the bankruptcy court and have legitimate assignments, and people who want to sell their property and can't get clear titles because of these temporary restraints on the funds.

The biggest problem was the involvement of Cochise College Park, in addition to the regular companies that sell lots more than once, and they sell fraudulent mortgages, they sell land that they don't own. Cochise College Park was put on hundreds of assignments and recorded because there was about over \$1 million that they sold in mortgage contracts to assignees all across the country. Now, how they did this—they sold it through different investment companies. Rush City, Minn., where the man was convicted later, and we have some of the victims from that, as I remember.

Now, the big problem that was created, I think, is because—when Mr. Jedens became trustee, in the first place, we were very surprised. I am an accountant, and when it was put under title 10, we—I always thought, when I used to work, that it was where you restructure the business funds and save the company and carried on the payroll and pay your creditors, but it's not that way at all. In fact, it's run for the benefit of those who carry on the proceedings.

Some of the people that write to me have been more cruelly victimized in the proceeding of the court than they ever were by the swindlers themselves, and they're very bitter. I think before we have been referred to as a disgruntled people who have been swindled.

We have worked very closely with some important people, and people who are very concerned, and I think that you might like to know a few things. They have given me permission to read these, and the real estate commissioner wrote back in 1977, and shortly after he spoke before a group here and he said:

I, too, have noted the drastic increase in the number of land companies which have taken bankruptcy. When I see bankruptcy courts organizing vast marketing schemes in open defiance of interstate land sales acts, and in open violation of the various land sales acts of the different States, I am becoming more and more convinced that some of these bankruptcy judges know full well what they are doing.

Then he said:

In some of those cases where the trustees receive large fees, I have noticed a concerted effort to avoid cooperation with governmental and private institutions, who attempt to work out practical settlements to the problems faced by the lot owners.

And then he said that he was very thankful that we were continuing our efforts.

Now, there were many people from the Midwest that were caught in this, and they are involved in this bankruptcy. And the Iowa prosecutor and the attorney general's office wrote me a long letter, and we have been corresponding because he was telling me some of the problems he had in trying to get some justice for these people. And I will just quote a little bit.

He said in this letter:

Unfortunately, bankruptcy proceedings are used as a final step to complete the fraudulent activities of many companies.

Then he said:

For practical purposes, this office has abandoned any attempts to obtain any redress for Iowa victims in an Arizona Federal bankruptcy proceeding involving land companies, as all such efforts expended by us in the past have basically proved almost fruitless, with very few exceptions.

Mr. DeCONCINI. I remember you sending some of that material to us and, frankly, it had some influence on the revision of the code that we passed last year. I am sorry it hasn't been of any help in your particular case.

Mrs. BRUNNER. The last one was just from the attorney general of Minnesota, and I don't know whether I sent that or not. He said that he was writing to a member of the Banking Committee, the House Banking Committee, saying that he did not believe that the Congress ever intended to confer such authority on bankruptcy courts, because they were attempting to get a bankruptcy court to consider an application by the trustee to allow the trustee to sell subdivision lands to residents in a number of States without compliance with either the Federal act or the State act, and that was described as junk land by Mr. Sidder in the—

Now I will get to what our case—but we did have other people, too, that have encouraged us and realized the problem. The big problem was is they have them handle too many bankruptcies in this case, they have so many different ones, and it's a big job to try to iron out all this fraud and try to do justice to this many people as possible.

Mr. Jennings was very involved with development of his own writeup in our area, and this is why we attempted to go down and

object, because we felt that he had a conflict of interest, and that's the privilege of the people there, but we never were able to attend, because by putting—they kept these three bankruptcies separate.

The holding company was simply sold as—was the one they concentrated on at first, and the poor people didn't know what they were talking about when they sent all this. They had bought from Great Southwest, and Lake Montezuma Development, so they put the different dates, and then there would be conflicting dates, and finally we were expected to go—the judge even had two different dates for these different ones, and then a third one, so when we were going to go in July, why, the 14th, we read in the newspaper that it was all settled, and no one objected, so we didn't go. And we tried later to have him removed, because of the way—and it was hopeless, and even though other people did too. Our petitions through an attorney were rejected.

The thing that has happened that has really caused so much trouble, is that he hasn't abided by, and they haven't abided by the bankruptcy laws. We know there is a new law, and we are pleased about it, but if they violate the new law just as they did the old one, then it's not going to bring about the praises that we hoped it would.

Here is the thing: Glenn Liphard, who was the vice president and Glenn Cole, secretary-treasurer, they were the ones that petitioned for that. Now, in the note and in the time sheets we find that Mr. Jennings, while he was too busy to talk to any of the people who were swindled, or the groups he met with, and the people that later went to prison, and even as late as 1973 he consulted with them. The attorneys for the fraudulent companies had many times and other attorneys who were representing some of the people that later brought out that they were among those that were in with the swindle, and so that made—the people couldn't understand that, and they have never been able to get the correct information.

I will say that Central Service Bureau, who took over the accounts just before bankruptcy, shortly, and became the company that sent out the funds and handled the funds, were very helpful to us and to the people when no one would answer their questions, and they could tell them, you know, and they also had good records, considering such a fraudulent company.

And when they took over, and this collection agency would give them the material, why, they went over to Great Southwest and said that they wouldn't take the case unless they would let them photocopy the different accounts. Well, it turned out that they left a lot out of the ones that were unrecorded that they had put down unrecorded. They could never, even though they were on Mr. Jennings' category sheet which he prepared instead of his—what you are supposed to prepare, according to the law, is the name, the addresses, the identifying, the phone numbers, the addresses, and that was never done.

I don't know whether I sent you any of the category sheets or not, but they are first initials, and they are crudely written, and there are hundreds of errors on them, and they don't show. He worked with the Central Service and went over and reviewed the records, and they sent them to him with the legitimate assignees, but he never used them in a great many cases, and this is what created the great problem when they put this temporary restraining order on, and we were just shocked about it, that it continued, and it still, in effect, for some

people since 1972, a lot of people were relieved during this class action that was just settled in December.

This is what happened to the people, and they didn't get their money all these years, and it's held up where it's legitimate, and they paid no attention when they sent in proof that they are legitimate assignees, and there is no proof Cochise College paid any of this for this, and they still remain on there.

Now, he also was supposed to, and this would have altered some of the people that they'd better investigate and better look in their records and see that they really have an assignment that their mortgage had been recorded, and he didn't send out a report of fraud, and that's one of the things required under the old law.

Your people who had no access to the newspapers here didn't know about the fraud until some of them got in touch with us, so they didn't know that the Cochise College Park, the processing department had really fooled them and sent them the mortgage, the recorded mortgage, the assignment—it was all stapled together, and their assignment was not recorded, so they had no record. Now, the bankruptcy court trustees and the judges have gone along with it, and seemed to think no one has any right if their assignments or their purchase is not recorded. This is what the swindlers do, they record the legitimate things, they record a good many of the ones that were not. We feel that the people are benefitting right now, and going to benefit in the future who were part of the fraud, because there is just many people on these that never bought lots.

Now, as soon as this is released from bankruptcy, if no one fouls up on that, they can buy them up at a tax sale, and the person who bought the tax assignment is going to—there is no chance for him to get anything.

I would like to bring up three different—the way they handled—I think it will tell with three different trustees, how they handled lots that haven't been released from trust for beneficiaries, and to show you that they are not concerned at all about the people involved and who are being swindled, but they are concerned about what is best for them, and what is—they always say that they are doing this for the estate, but this is not true. When they put in fees for more than all the assets, after they had sold Lake Montezuma, the golf and country club, and the big settlement with the Consolidated Financial—of \$360,000, and their bill now exceeds this—they are not concerned about these people.

The first one was the Hergerberg trust, and I reviewed that agreement that he had with the Lake Montezuma Development Corp.—deleted where the payments were supposed to start. It said that schedule A was supposed to be attached, and would we release—that was never recorded. Fifty-seven of those were released, but yet the court ruled in favor of those. Those lots were—some of them were good; some of them didn't have water, and they finally decided—one attorney wrote one of our members and said that the court was willing to turn them over to Hergerberg trust until they argued there had been enough money to pay, and that they shouldn't release some; they just decided—

Senator DeCONCINI. Did your members bring a lawsuit against Jennings?

Mrs. BRUNNER. Central Service did.

Senator DeCONCINI. Who is Central Service; who did they represent?

Mrs. BRUNNER. They felt they were responsible for the people to get this money, and they said that they were trying to get the money. Central Service is the collection agency.

Senator DeCONCINI. The Montezuma vested rights group did not bring any action?

Mrs. BRUNNER. No. We attempted to establish our trust rights and have a jury trial, but before we did, they quickly brought in a—they exhausted all of our money in legal fees by trying to sell the golf course to a man who was from Detroit, along with the Coconino County attorney, who was going to be one of the others to buy it. But we stopped it, and he was convicted last year in the court, and this one from Detroit, and so we are very pleased he did not get the place—and was involved in other similar frauds in Detroit, and was involved in a \$200,000 bankruptcy that came out.

The most important thing that just really bothered people was that they thought that it was so unfair. The three officers, just for bankruptcy and the short time before, divided up the assets by themselves; they deeded them to each other. There was a Phoenix home, the recreational building of Indian Lakes, which was a very good place, and had been promised to a lot of purchasers, and there were about 325 lots there, and a villa there on 4 lots, and they were deeded to each other by Cornwall, Cole & Liphard. Now, the home was reclaimed by the court and declared a fraudulent activity. However, the man who had sold the home to Great Southwest was really treated terribly, because he never had the opportunity to get his—he had received \$2,000, and he is a member of ours, and he wanted to be a member—an associate member—and he was told by one of the attorneys of the trustee that he could pay the \$2,000 as soon as they set aside the fraudulent transactions, and that he could have this—have his home—because he had gotten fraudulent mortgage contracts for his equity.

He attached a letter, and we have a copy of it. His attorney told him, when we were going to set this—when he came over, his home was gone. They had sold it in bankruptcy court without him knowing anything, and he is a very bitter man. They would not ever reclaim the other places, they sold them, they were recorded—the sale of the house by Liphard, to an attorney in the area who was a neighbor, and it is recorded after the collapse of the company.

The recording of the villa, that would have been an asset to Mr. Cole, is recorded after the collapse of the company, but I wanted to get to the next trust.

These people did get their money back, who paid the release prices in the—

Senator DeCONCINI. We are going to be running out of time. Would you like to summarize what you think would be helpful to the committee?

Mrs. BRUNNER. Yes. We feel that there has been absolutely no justice for—nothing at all. It is as if they were working above the law, and I have never—I sincerely thought I could bring the problems before them.

Senator DeCONCINI. When did you testify?

Mrs. BRUNNER. I testified in 1978.

Senator DeCONCINI. What action did you testify in?

Mrs. BRUNNER. I testified—I came in to testify why I didn't think Jennings should have his fees; we were permitted to do that. I was sincere in trying to bring forth anything that I thought, perhaps, the bankruptcy judge—I know he didn't know some of the things, because he was shocked, and he was so angry, because he said: That isn't true. And I had the documentation. They threw out all of my testimony, written, and what I had said, and I have never in all my life been treated to such harassment and verbal abuse as I was by the bankruptcy judge and the attorneys representing the trustees. They resented all of this. So, anyway, I am going to give you the report that I have, and some others.

Senator DeCONCINI. I would be glad to have that. For the record, I have looked at some of the things you have sent us, and my staff has reviewed them and, unfortunately, I don't have any jurisdiction to do anything; we have turned them over to the various law enforcement officials.

Mrs. BRUNNER. We feel we are not satisfied with the investigation that has been conducted.

We have the whole report from the Freedom of Information releases, and our most important case histories, and the charges have all been deleted; in fact, it came as quite a shock to me and to our members, but I did want to say that lots were sold for \$100 by a trustee, this latest trustee, in Gila County, to a man who is supposed to be sophisticated in building, and included the water companies, and all these poor people who had presented claims, some of them as high as \$6,500 on an assignment—didn't even know about the hearing, and had no chance to—

Senator DeCONCINI. No notice?

Ms. BRUNNER. Now, no one in business would be permitted to do this. We are pleased with what the prosecutors are doing in getting these people convicted. For so long they considered them civil cases, and we sympathize with them, in that they know that they didn't want to irritate Federal judges, but we feel we have been let down by them, and we feel there should be an impartial out-of-State investigation so that they won't be concerned with it. We tried to talk U.S. Attorney Smitherman into it. We thought that if he would let us have them, and there was a team of investigators. I went to Washington and talked to the House Judiciary Committee attorney on one of the committees, and he said that there was a team available but we weren't permitted to have it, so I would urge that—because I think one will open up. I would not have lasted 1 week in business being a chief accountant, and I wouldn't have lasted a week if I had handled it like this has been handled, so, anyway, I will—

Senator DeCONCINI. Thank you very much.

Ms. BRUNNER. And the final think I want to say, to show you how errors can get in, and there is no checking balance system in this bankruptcy, and I just wanted—one closing thing. I stumbled on this. Being an accountant I look for things, but it was put in—nobody checks it if there are mistakes. It was in Mr. Hamlon's records, and he was one of the—he was carrying out with five different trusteeships of big

companies, and they were all put into Carpenter Investment Co., Growth, Rosso, where there was the big scandal, and Western Growth is still going on under reorganization since 1967, and people did not get any justice there.

All of a sudden I saw them, and I added them all up, and I was amazed. I couldn't believe my eyes, and I kept thinking I must be making a mistake. There were 338½ hours on the timesheets for March 1, 1975, through March 31, 1975. Now, at \$35 an hour, if that had been, and it's in the records, that would be a bill of \$11,847.50 for the month, and they didn't even realize what had gone on before, because they included lots that had been taken away in trust and given back to the beneficiary in deeds that they gave to the buyers, so—

Senator DeCONCINI. It sounds very unfair, indeed. I wish I could solve the problem for you.

This will conclude the hearings. The record will remain open for anyone who cares to submit any further testimony.

As to the Montezuma problem, I must advise you that we are not a law enforcement agency, and we can only do oversight and try to correct major legislative problems. I have on numerous occasions asked the prosecutors to reopen that investigation and to look at it, and they have, and they continuously come back to me with various reasons that nothing further can be done. I don't know what else to do for you. I feel you have been abused, but I just don't know what can be done.

Ms. BRUNNER. Would you like to have the letters that we have?

Senator DeCONCINI. I would be glad if you would send those to us.

Ms. BRUNNER. And HUD, too. They say in there that they would go ahead with it, but they are restricted by bankruptcy. I don't think bankruptcy should be above the law.

[The prepared statement of Ms. Brunner follows:]

PREPARED STATEMENT OF FRANCES S. BRUNNER

As a member of the board of directors of Montezuma Vested Rights Inc. I wish to thank the committee for giving us this opportunity to present facts concerning bankruptcy proceedings in the District Court of Phoenix, Arizona.

We are a nonprofit organization which began in 1973 with five people who were determined to see that the prior trust rights of several thousand investors of Lake Montezuma property were protected. Bankruptcy court appointed trustees and attorneys were ignoring the law in regard to the rights of those who never invested with the bankrupt companies but who had purchased property at Lake Montezuma before Great Southwest Land and Cattle Corp. and Lake Montezuma Development Corp. were involved.

We now have approximately 1,000 members from 33 States, Japan and Canada. We have no paid workers but only volunteers who obtain information from bankruptcy files, county records, and from any other sources. Some of us have traveled to Phoenix many times since the bankruptcy proceedings under reorganization began in 1972. Our statutory agent Kenneth Camp and Mrs. Camp, Consultant, and CPA Matthew Ritchie and other members of our organization attended many of the hearings. We shared this information with State and Federal officials from Arizona and from a number of other States, with attorneys trying to help their clients and with many individuals all across the country.

Complaints of injustices and violations of the bankruptcy laws were sent to the Justice Department of Washington, D.C. and also to congressional committees. However, this was done only after we learned that the many complaints sent to Phoenix Federal and bankruptcy judges were merely passed on to court appointees.

In June of 1975 a Federal investigation was ordered by former U.S. Attorney General Edward Levi who turned the investigation over to former U.S. Attorney

William Smitherman who had stated their activity was overworked and understaffed. We had requested an impartial out-of-state team from Washington, D.C., which we had been told was available.

For many years Federal officials, as well as county and State prosecutors had considered the land swindles involving the loss of many millions by the public in developments as civil instead of criminal cases. It was Detective Lonzo McCracken of the Phoenix Police Department who investigated and was instrumental in the convictions of those involved in fraud in Great Southwest Land and Cattle Corp. (See exhibit 1.)

#### PROBLEMS OF INVESTORS

It was not until land fraud in Arizona reached epidemic proportions that new laws were passed by the State legislature to protect the public. Developers had continued to sell land previously they did not own or the same lots more than once and did not make improvements promised and documented. However, these swindlers before bankruptcies made most of their millions by selling fraudulent mortgage contracts all across the country.

To further complicate matters Great Southwest Land and Cattle Corp. and Lake Montezuma Development Corp. recorded mortgage assignments naming Cochise College Park, Inc. as assignee on hundreds of mortgages on lots at Lake Montezuma, Beaver Valley Estates and El Cid Developments in Yavapai, Gila and Maricopa counties.

Irving Jennings, bankruptcy trustee, did not use the information obtained from Central Service Bureau, collection agency. In January of 1972, when they agreed to service the contracts previously handled by Standard Title and Trust Agency they were furnished ledgers by Great Southwest Land and Cattle Corp. which they copied for computer records. Jennings also used their entire computer file many times and was sent their computer reports. Yet on category sheets showing classifications and lot purchasers and assignees, he showed only Cochise College Park instead of individual assignees who had paid cash for the mortgage contracts. Even when many of the assignees furnished proof when filing claims these category sheets were never corrected. No one has yet furnished any evidence that Cochise College Park paid anything for these mortgage contracts.

In 1977 James Hamblen, trustee, who had replaced co-trustees Irving Jennings and Louis Melczer in November of 1974, wrote in a letter to one of our members, "In the files and records of this Estate I have not been able to find wherein any monies were paid by Cochise College Park to Great Southwest Land and Cattle Corp. for these assignments of mortgages." Also "I firmly believe legal counsel will have to take some type of action to clear title to lots wherein Cochise College Park is involved. In October, 1976, this trustee compiled a list of the lots on which Cochise College Park is somehow involved and same was supplied to my counsel and all other involved attorneys. However, at the present time to my knowledge no action has been taken concerning this to enable this Trustee to proceed to clear title to this type of lot transaction."

It is also important to show how so many assignees believed their assignments had been recorded. We have copies of letters sent to assignees by Linda Schellhorn, manager of the processing department of Cochise College Park which says "We are returning, for your files, the Original Assignment of Mortgage covering your purchase of the above referenced mortgage. Please note, the mortgage has now been recorded and this assignment is now complete. These documents should replace the copies in your assignment folder." Although their assignment was stapled to the Cochise College Park assignment, this had not been recorded. After bankruptcy some discovered this and recorded their assignments but many did not. Others never received the original assignments, Mrs. Schellhorn worked for the trustee of Cochise College Park after bankruptcy. (See exhibit 2.)

#### IRREGULARITIES DURING THE PERIOD OF MAY 72 TO NOVEMBER 74

1. Court orders and notices as well as newspaper announcements and articles gave conflicting dates as to the time fixed for hearing of objections to the retention of Irving Jennings, trustee. A group from Lake Montezuma planning to attend and object believed they had missed the hearing when a newspaper article said there had been no objections at the June 26 hearing. Court records later showed that in addition to Trustee Irving Jennings and attorney from Brown Vlassis and Bain representing him only the attorney for president of McDonald

Inv. Co. of Rush City, Minn., H. J. McDonald, an attorney for River Land Co. and a representative for the Coffee Man, Inc. attended. McDonald Investment Company had sold mortgage contracts to assignees and River Valley Land Co. was the beneficiary of a trust involving Montezuma Haven lots. There were no objections. (See exhibit 3.)

[Exhibits 1, 2, and 3 are on file with the subcommittee.]

2. Chapter X (rule 10-208(a)) of the Bankruptcy Law requires that the trustee file a report of any facts found as to fraud, misconduct, mismanagement and irregularities. Also the order by Federal Judge Walter Craig stated this must be done and then presented to him before submitting it to creditors, stockholders, Security and Exchange Commission and others which the law states must be notified. No report of the great fraud, which was apparent from the records, news stories, two \$8 million civil suits filed against companies and those involved, was ever sent or appeared in the records on file at the bankruptcy court. The Security and Exchange Commission Chief of Reorganization also confirmed that they had not received such a report.

3. At a meeting on May 20, 1972, at Lake Montezuma, Irving Jennings, trustee, told a large crowd that when lots had been sold more than once there were enough lots to go around so substitute lots would be offered. This encouraged investors to continue payments on lots they could never own due to prior claims. We found no evidence that any lots were ever substituted by and of the trustees. On January 15, 1976, Ned Warren of Consolidated Acceptance Corp. signed quit claim deeds for 32 Lake Montezuma lots giving title to the bankruptcy estate with James Hamblen as trustee. In 1977, 59 more Lake Montezuma lots were obtained by the bankruptcy estate in settlement of a suit by Consolidated Financial Corp. (This was the company that was created when LMDC was sold to GSWLCC. They were former owners and developers at Lake Montezuma when they and Ned Warren bought the development from the Herbergers in 1967.) CFC had sold LMDC to GSWLCC in 1970. St. Paul Title and Trust Agency in November of 1978 deeded four lots to Charles Hallett, who had been appointed bankruptcy trustee. (Standard Land Title and Trust Agency, which had merged into St. Paul had been the trustee for Classic Inv. Co. in regard to Indian Lakes.)

4. In May of 1972 Trustee Jennings sent information to lot purchasers that pursuant to the order of the court they were to continue making their payments. There had been no such court order.

5. May 31, 1972, Attorney Sherman D. Fogel, representing attorneys for Trustee Jennings, signed a Petition for Turnover Order and Temporary Restraining Order stating that the petitioner, Irving Jennings, believed that the estate would be immediately and irreparably harmed unless there was a temporary restraining order. Also that on information it was believed that these payments made on contracts by lot purchasers belonged to the debtor and/or its subsidiary corporations.

On June 1, 1972, U.S. District Judge Walter Craig signed an Order to Show Cause and Temporary Restraining Order prepared by Brown, Vlassis and Bain, attorneys for trustee. In addition to making the temporary restraining order effective immediately, he ordered that Carl and Lou Arndt d/b/a Central Service Bureau, and each assignee as reflected in the books and record were to appear before Referee in Bankruptcy, Vincent D. Maggione on June 8, 1972, to show cause why these funds should not be surrendered to the trustee, Irving Jennings.

Central Service had taken over the full service of 1,145 contracts. It was further ordered that each and every assignee was to receive a copy of the order and petition mailed on or before the second day of June, 1972.

Very few of the assignees were from Arizona. The great majority were from the Middle West but there were some from Virginia and Washington, as well as many other States.

6. The law (210) requires that the names and addresses of people the trustee represents, nature and amounts of their claims and time of acquisition be submitted for bankruptcy records. This was never done. Instead a category list of lot owners, assignees, contract numbers, lot numbers, receivable balance and payments in trust was prepared. There were only initials for first and second names and last names but no addresses. Thus those with similar problems attempting to locate others and be represented by one attorney were unable to do this.

The comptroller working for the trustee testified before the Security and Exchange Commission attorney at the bankruptcy court and said that he believed from 90 percent to 95 percent of the classifications were correct. He was

praised by the referee in bankruptcy for an excellent job. Yet there were hundreds of errors in these classifications. Anyone who reviewed the "C" and "F" categories, which stated in the heading that Deed was recorded, would know that only one of the two purchasers of the same lot would have a recorded deed.

Knowing that many of lot purchasers and almost all of the assignees were from outside the State they would not be examining the sheets but only told what category they were in. These classifications also never revealed that hundreds of lots had not been released from blind trusts. Most of these investors were put in category "B" which merely stated "owned and Purchase Agreement in File. Nothing recorded". Yet the trustee and attorneys had to be aware that many lots had never been released from the different trusts.

7. Section 70 of the Collier on Bankruptcy gives the trustees the rights that the bankrupt had, but it does not destroy those interests of parties who were not included in the bankruptcy. Yet the different trustees ignored all the documentation and exhibits of about 2,500 lot owners who had purchased their property with the assurance that they had transferable golf and country club memberships with the lots they purchased beginning in 1960 and all before the now bankrupt companies became involved. Attorneys representing MVRI submitted much evidence for the record which was completely ignored, including a recorded letter from one of the former developers to the assessor, asking that \$500 of the lot price be excluded from assessed valuation in subdivisions because this was for golf and country club membership. Yet in letters, notices and even petitions by trustees and their attorneys reference was made that there was no evidence of these prior rights of memberships.

Before the apparently planned bankruptcies three officers of the companies deeded a Phoenix company home, the Indian Lakes administration building at Lake Montezuma promised to investors as their recreational property, and a Lake Montezuma villa to each other.

Glen Cole, secretary-treasurer, signed the deed giving the home to James Cornwall, president, who then deeded it to his sister, Iverna Tompkins, who was on recorded documents as executive vice president. James Cornwall deeded the Indian Lakes property to Jay Lippard, vice president and then Lippard deeded the villa to Glen Cole. Only the Phoenix home was reclaimed by court order and declared a series of fraudulent transactions.

Lippard and Cole, whose petitions for reorganization of the companies were approved although success in the future with the great fraud was hopeless, were able to benefit financially. Lippard disposed of the property at the time of the collapse of the companies to Michael L. Murphy, attorney, at far below the appraised value as shown in the records of another bankruptcy involving Indian Lakes. Few were aware that the Montezuma Hills Development Corp. bankruptcy was going on until May of 1973, with Louis Melczer serving as cotrustee in that bankruptcy with Glenn Taylor and also with Irving Jennings. The recorded deed from Lippard to Murphy shows it became a matter of public record on April 17, 1972, 10 days after the collapse of the companies. The deed dated March 24, 1972, received by Glen Cole was recorded April 11, 1972.

The Texas couple who had been swindled when they sold their home to GSWLC received only \$2,000 cash and fraudulent mortgage contracts based on deeds issued by Thomas Cornwall, then secretary-treasurer, had a letter from attorney Henry Jacobowitz who with other attorneys from Brown, Vlassis and Bain represented the cotrustees. Copies of this letter had been sent both to Jennings and Melczer saying that the couple could reclaim their home if they paid back the \$2,000 down payment. They agreed. However, when they came over, after learning from their attorney that the fraudulent transactions on the home had been set aside to pay the \$2,000, the home had been sold. Louis Melczer, cotrustee, had petitioned the court to sell the home merely saying in the report of sale and petition for confirmation of sale approved by bankruptcy and Federal judges under "13" that Clyde T. Carter, et ux, represented by his attorney, claim to have some interest in this property on the basis of an alleged right to rescind. However, your petitioner believes and therefore alleges, that there is no validity to the claim."

Certainly this alone that has been reported so far shows that bankruptcy trustees are given almost absolute power with their attorneys and that bankruptcy and Federal judges merely "rubber stamp" what is prepared by attorneys representing trustees.

Time sheets of the trustee will show that those later convicted and sentenced to prison for fraud and attorney representing the companies involved in the great swindle were able to have conferences in person and by phone with court appointees. Yet those who had been swindled and were worried about losing everything could not even get information. Neither could many attorneys representing individuals. The complaints of irregularities and injustices sent to Federal and bankruptcy judges either ignored or passed on to those responsible for what was happening to them.

Petitions and letters asking that bankruptcy trustee Irving Jennings be removed were rejected or ignored. Paul Bonn, attorney for trustee, in his motion to dismiss an amended petition to remove trustee, stated petitioner lacks standing to bring the petition and, in any event, the petition fails to state a claim upon which relief can be granted. Philip Higdon, another attorney for the trustee, petitions Judge Maggiore to dismiss it on the grounds that the attorney failed to file with the court the statements required by 210 and 211 of the bankruptcy act so he cannot be heard in the case. He also adds that the petition fails to state a claim upon which relief can be granted. The petitions were rejected.

Surely Congress, when they passed the Federal Bankruptcy Act many years ago, never could have imagined that it could be used in this manner so that investors, originally defrauded by unscrupulous land promoters, have less opportunity for justice in the Bankruptcy Court and are more ruthlessly victimized than by fraudulent land promoters. Even the first creditor's committee bankruptcy records show in July of 1972 include attorney for an investment company president sentenced to prison for fraud several years later.

Those who tried to obtain information or tell of irregularities were asked if they were represented by an attorney. Often they were deprived of their constitutional right to represent themselves at hearings and were ridiculed.

Since our organization started I have experienced more harassment and verbal abuse from a bankruptcy judge and attorneys representing trustees than from anyone else in my entire life. I have been told that I may be in violation of a misdemeanor statute which prevents the practice of law by a layman for the benefit of others. When I was finally permitted to be heard and attempted to reveal irregularities and violations of the law I was interrupted, yelled at, accused of giving false testimony when I held the proof in my hand, and after 1 day on the stand and on into the second all my written objections and testimony was stricken from the record.

8. In the June 7, 1972, order by Judge Walter Craig under item 11, the trustee was to keep proper accounts of the earnings, expenses, receipts, disbursements and all obligations incurred and transactions had in the operation of the business and in the management of the property within the estate. Trustee Jennings ignored this order. There were no proper records kept and inserted in the bankruptcy files. Yet at a public meeting at Lake Montezuma March 14, 1974 trustee Jennings told Judge Maggiore that such a report was already in the files up to November 1973. However, MVRI attorney, Amelia Lewis, examined the files thoroughly and wrote us she could find no such report.

Matthew Ritchie, CPA was told he could do the audit and then was told by the judge he could not as it might be a "witch hunt".

9. Attorney Allan J. Besbris of Banker's Finance and Holding Co. prepared an ex parte order asking for the release of mortgages owned by them from the preliminary injunction issued by the court. This was dated February 12, 1973, and listed a group of mortgagors with lot number and subdivision. This order stated that the mortgages were owned by Banker's Finance but they were owned by individual assignees who had purchased them for cash. Attorney Bruce Rabbitt and Referee in Bankruptcy, Vincent Maggiore signed this order. As Irving Jennings had withdrawn the contract payments during 1972 on two of these accounts it was necessary to pay this back so the money could be disbursed. Central Service disbursed the money to the individuals and not to Banker's Finance who had said they owned them. Both Attorney Besbris and the president of this company were sentenced to prison on other charges of fraud.

10. An attorney from the firm of Lewis and Roca wrote Central Service Bureau on May 23, 1972 that they were informed that payments were being withheld from assignees by reason of a request from "Irv" Jennings. He demanded that the funds be released as the firm was representing a group of Indiana assignees who had invested a large amount in Great Southwest Land

and Cattle Corp. mortgage contracts. They wrote "Your records will clearly indicate that neither Educational Computer Systems Inc. nor its subsidiaries, Great Southwest Land and Cattle Corp. and Lake Montezuma Development Corporation, have an interest in the collection accounts held by you and which you are supposed to be servicing."

Apparently they pursued this on behalf of their clients. So an exception was made and on December 21, 1972 an Order and Master's Report was signed by Judge Maggiore, Attorney Bruce Rabbitt, Attorney for Chapter X Co-Trustees and Attorney Joseph E. McGarry of Lewis and Roca. A category "M" or "Lis Pendens" was created which included all the categories from "A" through "L". This was approved by U.S. District Judge Walter Craig. Thus contract payments were released from trust accounts even if the lot purchasers did not have title to the lots and had no chance of receiving recorded deeds as there were prior claims by other investors or lots had not been released from trusts. Not only did the individual category sheets not reveal that lots had not been released from trusts but the Summary Category sheets did not show that several hundred lots had not been released. When investors in lots in a few cases became aware of this and wrote to the judges they were told by the bankruptcy court judge that "As an officer of a Court I have the sworn duty not to prejudge the same until such is brought before the Court by proper filing of necessary proceedings." Once again procedure rather than what is just takes precedence.

The order also states that it would be unduly burdensome to send notices to all persons presently receiving notices and that only those persons or parties directly affected by this order and report were to be notified. From information we have obtained from several of the lot purchasers involved they were not notified.

Why were these Indiana assignees given special treatment? Also later when lots were reclaimed in the Herberger Enterprise Inc. trust by court order, why didn't Lewis and Roca protect the interest of their clients who had invested \$28,468.60 in these lots. Not one of them paid the release price which was later returned by the Herbergers 1 year after payment to each of the 5 of the 54 who paid release prices within 10 days of the court order of July 1973. Also when trustee Charles Hallett petitioned and gained approval for a bulk sale of Beaver Valley Estates to one developer for \$100 each involving 75 lots why didn't Lewis and Roca protect the interest of their two clients who had purchased just two of these mortgage contracts at \$3,116.50 and \$6,493.25. Yet notice to clients stated their fees for the 30 couples and 14 individuals were \$152,000. as of October 1978. Also they had obtained a settlement for their clients of \$70,000 from Standard Land Title and Trust Agency. Yet this agency was not even named in the suit by court appointees in 1974.

By this special treatment some lot purchasers making payments on lots they could not own, were not only deceived and not informed about lots held in trust, but were not even notified of this order which released their payments from trust funds. When I testified on February 1 and 2, I attempted to give facts regarding the order and masters report but apparently Judge Maggiore was of the opinion that only ABC categories had been released.

11. One of the many assignees whose payments had been withheld by the temporary restraining order received special court action to obtain the release of the funds. The bankruptcy trustee had shown only Cochise College Park as assignee on many of the contracts although there was no evidence that they paid anything on these before they were sold to individuals. There were so many that simply could not understand why their payments had been stopped for almost 3 years.

On December 18, 1974, Louis Melcer, cotrustee, and Philip Higdon, attorney signed an application for order directing disposition of funds held pursuant to preliminary restraining order which stated that Donald and Janet Bartusek had submitted proof and were entitled to have all funds released held by Central Service Bureau with respect to Lot 84. On December 23, 1974 Judge Vincent Maggiore signed order approving special master's report. On Dec. 23, 1974 Judge Walter Craig signed the Order and Report Directing Disposition of Funds Held Pursuant to Preliminary Restraining Order. An exception was made and funds were released to the assignees. Yet when others had presented and also submitted the same proof to court appointees their claims were ignored. Many asked in letters to judges and court appointees why special treatment for assignees of this one lot mortgage contract. No explanations were given.

12. Herberger Enterprise Inc. blind trust had Transamerica Title Co. as trustee until just before court order of July 1973 when Minnesota Title became trustee: This is referred to again and again by investors re: the power of a wealthy and influential family corporation whose earned surplus was \$3,327,200 for the years 1969 through 1972. They had sold Lake Montezuma Golf and Country Club development to Ned Warren and associates in 1967 after selling more than 2,000 lots. Although they owned the Rimrock Water Co., until they sold it in 1971, many investors were left without water to lot lines which had been guaranteed by them and documented in many ways.

The following shows how court appointees and judges favored this company over the rights of individual investors:

(1) Herbergers with Transamerica as trustee turned over lots to Lake Montezuma Development Corp. with James Cornwall as president before any agreement was signed. (Some of these lots had been reclaimed when original owners could not pay the balloon payment after 5 years of all principal) Some lots sold to investors who were given recorded deeds before agreement was signed. Note that the dates are deleted as to when payments should start which the court appointees ignored. Also there was no schedule "A" recorded as stated so it did not show release price of lots.

(2) Application to reclaim property by attorney John B. Happ Jr. of O'Connor, Cavanagh, Anderson and others dated April 5, 1973 with copy going to Bruce Babbitt, bankruptcy attorney of Brown, Vlassis and Bain. Mr. Happ was not the attorney for Transamerica as stated but Herbergers' attorney.

This was a blind trust but court appointees and bankruptcy judge were aware of the beneficiary because letters from attorneys representing purchasers of lots involved in this trust reveal that attempts were made to work out a plan whereby the lot purchasers and assignees would not lose their investments. One wrote, "I made every effort at the Hearing which resulted in that Order to convince the Referee that an Order of the form which you received would be improper and would work substantial hardship on lot purchasers." This attorney also said he conferred with attorney for Transamerica Title Ins. Co., with Bruce Babbitt, attorney for the trustee in bankruptcy and with other attorneys that have long been involved in the bankruptcy proceedings. Then added "Prior to these conferences and prior to attending the Hearing, it was my hope, as you know that we could obtain good title to your lot by dealing directly with Transamerica as Trustee for the Herberger interest. In view of the Court's recent order allowing reclamation of these various lots, this appears to be without question, an impossibility."

Another attorney wrote Minnesota Title Co. that their Notice of Forfeiture sent that asked for a total of \$38,791.78 based on the July 9, 1971 agreement does not apply because their deed (recorded) with purchase date of May 30, 1971 was prior to this. Also he adds that in the records there was a release basis which was apparently partially paid before bankruptcy. His request for an answer was ignored.

Another attorney wrote to assignees who were involved that he had represented some local people who paid cash for the lot: "The Court was prepared to forfeit the entire interest to the Herberger Trust even though substantial sums of money in the form of release prices had been paid to Herberger as holder of the first beneficial interest under the trust. We were able to persuade Judge Maggiore to apply the sums previously paid to a prorata reduction of the lot release prices. The lot purchasers were then given an opportunity to tender the release price with the knowledge they would receive in return a Warranty Deed and title insurance and that the release price would be reduced prorata according to the total number of participants."

Also "In other words, if all of the persons whose lots were subject to forfeiture tendered the release price in full they would have received a portion of it back as a result of the previous payment by the developer. If less than all, they would receive up to the entire amount back. As only a few persons took advantage of this opportunity they received their entire release price back and a Warranty Deed and insured title to the property. Unfortunately, my clients elected, for reasons unknown to me, not to follow through with this procedure."

A number of the people who were involved in this trust were to become members of our organization later. We know that many did not even receive the court order saying they must pay the release price of \$800 to \$1,500 although Central Service had these records and had made them available. Some had recorded deeds so were on county records. They were unaware of any Herberger trust as they had been put in categories "E" "F" or "C". One California couple kept making payments

after the lot was reclaimed by Herbergers and had been resold. Others could not raise the money within 10 days of the court order. They had no idea they would get clear title.

Those who received the order would find it difficult to interpret it as this attorney did who had probably consulted with other attorneys and had been given additional information. I wonder how many people would interpret the order in the way it was presented to this assignee. The part 2 of the order reads: "In the event that any lot has been subject to multiple sales and the release price is tendered by more than one lot purchaser (or by more than one lot purchaser) or by more than one assignee in the event that the release price is not tendered by a purchaser), all checks shall be negotiated, the release price shall be paid to Transamerica or its assignees, the lot released from trust, and such lot and the remaining proceeds held subject to further order of this Court.

Part 3 of the order reads "The sum of \$12,000 (the amount stipulated by the parties which may be credited to the trustees for releases upon the purchase price) reduced by the costs of the trustees mailing of notice in this matter shall be applied prorata to reduction of the amounts tendered and accepted by the trustees pursuant to paragraphs 1 and 2 hereinabove."

Also on June 15, 1973, Jennings sent out a notice of hearing and stated under other considerations: "The trustees cannot make any recommendations as to the advisability of payment of release prices in individual cases. If the release price is paid the lot will be released from the lien of Transamerica. However, the lot purchaser may continue under obligation to pay any balance remaining on any note and mortgage subsequently assigned by Lake Montezuma. In some cases a given lot may have been sold more than once, thereby giving rise to potential conflicting claims of ownership. There is no assurance that the trustees will be able to provide improvements which may have been promised."

It is easy to understand why more people did not pay the release price.

For sale signs appeared on the Herberger lots before the notices of the completion of forfeiture were sent. One of the Lake Montezuma residents became so outraged when she saw these and read the ad in the paper regarding the lots that she wrote Judge Maggiore October 22 1973 about the signs. Also pictures were taken of the "For Sale" signs on the different lots. During the night the signs were all removed as they were still there late the night of October 23 but gone the morning of October 24.

All lots were reclaimed except five. They had paid the release prices but were still sent the notices of forfeiture and Minnesota Title as trustee reclaimed these lots also. However, when one of the lot owners became very angry and demanded to know why such a notice was sent asking over \$38,000 for release price, Minnesota Title told them it was all a mistake.

The lots reclaimed were sold without down payment and small monthly payments to Kenneth Edgar of Edgar Marketing (Edgar was former sales manager for Ned Warren controlled Consolidated Mortgage), and to Consolidated Financial Corp. for cash payment of less than the release price asked by court order.

The lots were sold to elderly widows and couples by Edgar Marketing at far more than their value and in trade agreements. They were unaware of the Herberger trust. The bankruptcy estate reclaimed the Consolidated Financial lots as we already stated.

Court appointees failed to abide by the bankruptcy law and recognize our documented prior trust rights presented to them. Finally Judge Maggiore agreed that we could have a jury trial to determine these rights. While preparations were being made we were not aware that Irving Jennings had been summoned and required to serve upon Gary Lodmell, attorney for MVRI group, a motion or answer to the complaint or that judgment by default would be taken against him, which he failed to do.

Instead of any judgment by default taken against him, we received a notice regarding application for approval of compromise by Bruce E. Babbitt of Brown, Vlassis and Bain, attorneys for co-trustee Jennings. He and attorneys representing him alleged that in answer to the petition to reclaim certain property filed about 1 year previously about April 26 1973, which included Lake Montezuma Golf and Country Club, certain lots and unsubdivided acreage adjacent.

2. Co-trustees have alleged that Classic Investment Co. obtained its beneficial interest in trust 44 in connection with a usurious loan to debtor Great Southwest Land and Cattle Corp. and that the co-trustees have equity in the aforesaid property above the true value of Classic lien (as computed without excess interest).

3. Beaver Creek Land Co. and Beaver Creek Golf and Country Club Inc. as assignees of Classic, have offered to compromise the aforesaid claims in accordance with the "Agreement to Compromise Claim and to Reclaim and Sell Bankruptcy Property."

4. Petitioner believes that the aforesaid compromise is in the best interest of the debtor estates.

Montezuma Vested Rights Inc. was forced to spend over \$7,000 in legal fees and expenses when this Application for Approval of Compromise dated March 19, 1974 resulted in pretrial and trial hearings. It was apparent from the opening remarks by Bankruptcy Judge Vincent D. Maggiore that he favored the compromise and sale to Marvin Richmond of Detroit and Attorney Michael Flournoy of Flagstaff.

Had our organization not exhausted all funds set aside for legal fees for jury trial and even gone into debt the following would have taken place:

(a) All prior trust rights of several thousand investors would have been set aside.

(b) Richmond and Flournoy would have merely paid only \$40,000 down on the Lake Montezuma Golf and Country Club property (appraised at about \$1 million) and a balance of \$100,000 only if they could get approval to sell lots in the Indian Lakes area because the size of the lots and rough terrain made them unsuitable for septic tank systems).

It was revealed at the hearings that Irving Jennings and attorneys representing him had not even examined the document that was supposed to be in existence whereby Richmond and Flournoy had paid a large amount to Classic for purchase of their lien. Also they apparently were not aware of the past record regarding Marvin Richmond of Detroit nor that neither Beaver Creek Land Co. nor Beaver Creek Golf and Country Club Inc. was on records of Arizona Corporation Commission.

In April of 1978 Marvin Richmond, formerly of Detroit and now of Scottsdale had admitted ripping off insurance companies in a series of frauds and has been sentenced by Maricopa Superior Court Judge Sandra O'Connor to 8 years probation and 1 year in jail for grand theft by false pretenses and filing insurance claim. In addition, he was ordered to pay back \$20,521.74 in restitution.

Thus court appointees tried to set aside the legitimate former trust rights of several thousand investors in property at Lake Montezuma and urged approval of this compromise and sale to Richmond and Flournoy.

James Hamblen was appointed trustee for ECSI and its two subsidiaries GSWLCC and LMDC. He also was court appointed trustee of Thomas J. Grosso Investment Inc.; Western Growth Capital Corp. and Western Growth Investment Co.; Carpenter Diversified Investments; All State Trailer Sales Inc. all in reorganization proceedings.

On January 28, 1977, James Hamblen, trustee who replaced cotrustees Jennings and Melczer the last of October 1974 wrote Judge Maggiore "After reassembling the files and records of this Estate, I have not been able to find an accounting of the Montezuma Golf and Country Club other than that supplied to this Trustee from a Mr. Bowman in a cigar box when I first received this case."

An article appeared on March 28, 1975, in the Arizona Republic "Reimbursement Pledged in Land Fraud—Sale of \$1 million in firm's assets". James Hamblen, court-appointed trustee said the defrauded customers will receive at least some of their losses. He then referred to the unsecured creditors who purchased land they could not own and said "They're the ones we're working for. We're going to try to reimburse them for all or a percentage of their money."

"Nine persons connected with the corporations (ECSI, GSWLCC, and LMDC) were indicted for fraud last year by a county grand jury. Eight were found guilty. Seven received prison terms or probation, and one was ordered to make restitution for his crimes."

Hamblen was appointed Dec. 6, 1974, succeeding Irving A. Jennings who had been a trustee since the firm collapsed in April of 1972. Jennings, Hamblen said repeatedly, has failed to provide him with a legally required accounting of his trusteeship.

In October of 1978 Charles Hallett, the third and latest court appointed trustee, said in regard to the bankruptcies when he replaced Hamblen that

those who bought land from the companies probably won't recoup their losses. "I don't feel at this point any creditor will get anything out of this."

Thus it appears that the bankruptcy reorganizations carried on for years only benefit court appointees and a few others involved. If Mr. Hallett is correct in his prediction it has proved to be a cruel hoax to have promised investors for years that the proceedings were carried on for their benefit as was done by court-appointed trustees and attorneys for the bankruptcy judge.

We will briefly review what has happened to victims of the land fraud during the time James Hamblen was trustee and was represented by Lester Penterman, court appointed attorney. We discovered from our research that two bankruptcies under reorganization were going on at the same time involving the Indian Lakes property at Lake Montezuma. Not only was Louis Melczer cotrustee in both bankruptcies of Montezuma Hills Development Corp. until May of 1973 but the cotrustees were represented by Lester Penterman, attorney who later in 1974 again became involved as attorney for Hamblen.

Audits of some of the bankrupt companies by an outside source was ordered by Bankruptcy Judge Vincent Maggiore. The result was the indictment and conviction resulting in a prison sentence for embezzlement in the case of the bookkeeper in the Thomas J. Grosso Inv. Inc. after the audit was ordered.

1. When such huge fees were asked by bankruptcy trustees and their attorneys in 1978 in the LMDC, GSWLCC and ECSI reorganization proceedings, a member of the Montezuma Vested Rights Inc. research committee recently decided to make a comparison with other bankruptcy proceedings handled by James Hamblen. We reviewed the time sheets that had been presented in the bankruptcy files and found the following regarding the hours shown as time worked in Grosso Inv.; Western Growth Capitol Corp., Western Growth Inv. Co; ECSI, GSWLCC, LMDC; All State Trailer Sales Inc.; and Carpenter Diversified Inv.

The itemized time sheets of the above companies showed 338½ hours worked by James Hamblen trustee for the month of March 1975. At the rate of \$35.00 per hour this would be \$11,847.50. Hamblen reported that he had worked 22 hours on March 10; 20 hours on the 7th; 18½ hours on the 17th; 17 on the 4th, and 16 hours on the 6th. In addition he reported that he had worked every Saturday and Sunday in the month of March.

This is just one example of what happens when court appointees are given almost absolute power in these bankruptcies and when bankruptcy and Federal judges merely pass on complaints they receive about the reorganization proceedings to trustees or their attorneys. They are permitted to carry on proceedings for many years until all assets are used for expenditures and fees.

2. On June 25, 1975, James Hamblen, trustee and attorney Lester Penterman filed petition to disaffirm executory agreements and stated to Bankruptcy Judge Vincent D. Maggiore that there were numerous parties claiming some right or interest in the Lake Montezuma Golf and Country Club who joined in the formation of Montezuma Vested Rights Inc. The trustee states that he has never been presented with any instrument or agreement in writing which grants or purports to grant any vested rights in this corporation or the people who formed and belonged to said corporation. This is an untrue statement and Bankruptcy Judge Maggiore knew this as a great amount of evidence of prior trust rights was presented by Amelia Lewis, attorney who represented MVRI in 1974 when an attempt was made to set aside all the prior rights and get approval for a compromise and sale. (Proof of prior rights included letters to the Yavapai County assessor's office in early sixties which states that \$500 of the lot price was to be excluded from the assessed valuation of the lots because this was for transferable country club memberships, individual letters, brochures, pictures of signs stating lot purchase price included golf and country club membership, ads from newspapers, and recorded documents by Consolidated Financial Corp. who sold Lake Montezuma Development Corp. to the now bankrupt company GSWLCC. Even references were made to the few charter memberships where active members never had to pay dues and during the time there was an excise tax they were only required to pay this on memberships.) In addition, Ned Warren, who purchased Lake Montezuma Golf and Country Club development along with associates from Herbergers in 1967, said in a deposition taken by Bruce Babbitt, attorney for Irving Jennings, trustee, that investors were given memberships as part of the lot price and also a year's free golf fee certificate was given to a number of investors who bought after 1967.

Members of our organization also met with James Hamblen at Lake Montezuma and discussed these prior trust rights which were a matter of record at bankruptcy court and elsewhere. David Richardson, attorney had presented information and consulted with James Hamblen as to our prior trust rights. Trustee and attorney ignored section 70 of the Collier on Bankruptcy which gives the trustee the rights that the bankrupt had but it does not destroy those interests of parties that were not included in the bankruptcy.

Hamblen and Penterman states "That the Trustee is informed and believes that it would be for the best interests of the debtor estates to disaffirm any and all executory agreements which may exist between the debtor estates and those parties claiming a vested right in and to any of the real property of the debtor estates and the Lake Montezuma Golf Course and Country Club." Also ignored were letters from investors, including attorneys, submitting information as to prior trust rights.

3. On April 23, 1975, James Hamblen sent out his John Doe letters, Anytown, U.S.A. stating that this letter was sent to them as a courtesy and that of this date they had received what they hoped was the complete files from the previous trustee. He further states that "We have found you listed as a lot purchaser, but no record of payments having been made or being made at this time, nor were any of the documents recorded. Because of the foregoing information, we are enclosing a Quit Claim Deed for you to sign and have notarized. This will enable this Trustee to offer this property for sale and issue to the purchaser a good and clear title." He then closes the letter with "If I so not hear from you in thirty days, I then will have to take some type of Court action to straighten this matter up."

Due to the fact that Hamblen used category sheets prepared by former trustee which had hundreds of errors and because he had not had time to review the individual cases or check with the collection agency who had records of payments made on lots he sent these letters to the following:

(a) People who had made payments on lots before and after bankruptcy with some having their lots already taken from them by court action in 1973 in regard to the Herberger trust with these lots already resold.

(b) Those who had been told by attorneys to put their payments into a trust account in their own name, notify the trustee and collection agency of this and not release payments until they had clear title to lots.

(c) Those who had payments held in trust at Central Service by the temporary restraining order of 1972.

We contacted some of those who signed quit claim deeds after receiving such a letter. Some were fearful they would have to go to court and they could not afford an attorney to represent them. Others who had paid money after bankruptcy as well as before were afraid they would be accused of being one of the more than 550 properties involved with fraudulent contracts. We learned also that some became angry and refused to sign but felt the bankruptcy court appointees were carrying on the fraud as they had filed claims and had presented them with documentation to the bankruptcy court.

We would like to present just one of the cases because it involves a young man from Canada. Also it reveals a shameful series of transactions and shows how little court appointees know about the individual cases and that their concern is not for the victims but to reclaim as much property as possible from investors caught in the great fraud in order to prolong these bankruptcy reorganization proceedings and collect huge fees in the future.

MVRI from research was well aware that John Wychopen had made a down payment on lot 117 Montezuma Park unit 7 and had been credited with 9 payments in lieu of repayment of his round trip plane fare from Canada and return. He did not receive a deed because this lot was one that had never been released from the Herberger trust. He received the 1973 Notice of Election and Declaration of Forfeiture from Benny Gonzales of Minnesota Title Company who were now trustee for Herberger Ent. Inc. Trust No. 1136. It stated that amount to cure the default was 10 payments of \$3,832.68 or a total of \$38,791.78 with forfeiture fees, and interest etc. It further stated that forfeiture would be effective on expiration of 120 days unless agreements were complied with by eliminating all defaults.

John Wychopen wrote us that "I think it was in the fall of 1973 I received a letter that I was to pay them \$40,000 in back pay because I did not make my payments. I signed the claim deed because they were writing that I owed them so much money, and if I didn't sign the claim deed they would take me to court.

I am sorry that I'm not able to help you any more as when I signed the claim I threw out the papers that I had, because I didn't want any trouble with them." "P.S. When I bought this lot, I was single at that time." This is the record on this lot before and after Wychopen signed the quitclaim deed prepared by James Hamblen.

(a) Herberger Enterprise Inc. was able to reclaim all of the 54 lots in the trust except five where either lot purchasers or assignees paid the release prices of \$800 to \$1,500 within 10 days and the evidence submitted to court that additional lots could be released from payments made before bankruptcy. This was by court order of July of 1973.

(b) This lot as well as some others was sold to Edgar Marketing and Associates Inc.<sup>1</sup> for \$1,710 with no down payment and small monthly payments. December 20, 1974.

(c) Affidavit shows that this lot was sold by Edgar on December 18, 1974, to an elderly Mesa couple for \$6,500, in trade agreement and with the buyers unaware of the Herberger trust. (Edgar was to make only payments of \$20.75 a month.) When exposed in newspaper the couple then sold to Edgar for \$2,900, August 6, 1975. Edgar Marketing then sold lot to Producers Realty and Investment Inc. at same address as their company and the company is one incorporated at the time with Kenneth Edgar's wife as an officer. Affidavit shows total consideration as \$2,600.

(d) June 3, 1975 John Wychopen of Canada signed the quit claim deed for James Hamblen, trustee which was recorded July 7, 1975. James Hamblen, trustee signed a quit claim deed as trustee for ECSI, GSWLCC and LMDC on May 21, 1976 with this appearing on the deed "Dated this 6th day of October, 1975. This Deed is being signed pursuant to instructions by counsel, Lester J. Penterman. This deeded Lot 117 Montezuma Park Unit 7 to Producers Realty and Investment Inc. The deed shows this was recorded at request of Arizona Title and Trust Co. and recorded document was to be sent to Producers Realty and Investment Inc.

(e) Affidavit dated October 8, 1975, and signed by Kenneth Edgar as notary for Robert McDermid as seller's legal representative. Seller showing lot was sold by Producers Realty and Investment Inc. to Florence R. DeMartinez, a widow, and Hector Martinez Jr., a single man for \$6,500.00. This was not filed with the Yavapai County office until June 17, 1976.

(f) James Hamblen, trustee had included Lot 117 Montezuma Park Unit 7 in exhibit "B" as lots which were to be included in the sale of the Lake Montezuma Golf and Country Club when the lease-option to buy of December 15, 1975, was signed. Also included were 9 other lots of the total 38, which had been reclaimed by Herbergers by court order in 73 and resold to Edgar Marketing or to Consolidated Financial Corp. which had purchased Lake Montezuma Golf and Country Club development in 1967 and sold it in December 70 to GSWLCC.

4. James Hamblen used the identical inventory lists that were recorded as schedule "D," book 639, pages 88 through 93, which were recorded when Lake Montezuma Development Corp. was sold to GSWLCC and recorded January 21, 1971 in lease-options to buy and also when information on property in attempt to sell golf and country club property. Hamblen had to be aware that much of the inventory shown on the schedule "D" was no longer a part of the development. The manager's home had been stripped of everything before bankruptcy. (Moss-Nowlin who signed the lease-option to buy in 1975 recognized the prior trust rights of investors in lots and a document was recorded which stated these rights. However, they were unable to complete the lease option due to financial difficulties with property in Texas.)

5. In 1976 James Hamblen contacted a Missouri doctor, who had purchased a mortgage on lot 72 and part of lot 73 Indian Lakes 2 for \$8,500, and purchased lot 54 from Guido Orlandi of Montezuma Hills Development Corp. The deed to lot 54 was recorded on March 24, 1969. However, the doctor never foreclosed on the other lots. Hamblen offered to get him clear title (even though this was in no way related to the Lake Montezuma Development Corp. bankruptcy involving Indian Lakes) free of encumbrances for a fee of \$625. The doctor agreed and received a trustee's deed dated July 21, 1976, and recorded August 3, 1976. In July of 1978 he received a notice that he owed back taxes 1968 through

<sup>1</sup> Kenneth Edgar, Pres. was former sales manager for Consolidated Mort. Co., (reportedly Ned Warren controlled company).

1977 plus interest and penalties. He refused to pay because Hamblen had assured him he would have had clear title free of encumbrances but had lied to him. (This is information from a signed statement by the doctor and a copy of the cancelled check for \$625 and endorsement by James Hamblen, trustee (Valley National Bank)

Having reviewed the Montezuma Hills Development Corp. bankruptcy files there was nothing that showed James Hamblen was involved but Lester Penterman was bankruptcy attorney.

Due to the strange circumstances we now know that court appointees all were responsible for the fine settlement made with Classic Investment Co. later whereby they received large cash amount and bankruptcy estate received the unsubdivided land and many large tracts. Could it be that the reason for this was that there was a plan to carry on these bankruptcies for many more years just like Western Growth Capital Corp. and attempt to sell Indian Lakes once again to developers? The lots are of little value with no improvements and the size and the rough terrain makes it unlikely that septic systems could be used. Furthermore the recreational building and lots were never reclaimed by court appointees from a former officer later sentenced to prison for fraud in regard to mortgage contracts. Also there is no water available to the lots as the investors were tricked into believing that water came from a well for the recreational building when, in fact, it was piped from one of the subdivision lots nearby in a separate development before Lake Montezuma Development bought Indian Lakes in 1971. A pump was used to pump the water from this empty lot but testimony under oath given before Judge Maggiore would have one believe there was a separate well system. There was perjury at this hearing.

6. Knowing that notices of forfeiture were sent out years after bankruptcy proceedings under reorganization began in the Western Growth Capital Corp. bankruptcy by trustee Hamblen, as Research Chairman of MVRI I became alarmed when I saw that 480 lots were listed in the report filed with the Bankruptcy Court October 3, 1975 (page 4) where the trustee states that he claims an interest in these where nothing was recorded. It seem incredible that proof of purchase and claims filed would be set aside simply because the swindlers before bankruptcy had not recorded hundreds of legitimate claims but this was done in Western Growth with court approval.

I wrote James Hamblen on November 13, 1975 asking why he believed he had an interest in these lots. Typical of the trickery and deceit that goes on during these reorganization proceedings Hamblen wrote me November 19, 1975, "In reply to your letter dated November 13, 1975, I am sorry I cannot find what 480 lots you are referring to in the Report. I am enclosing a copy of the Report made to and filed with Court. Please be more specific so I may give you an intelligent reply." He had prepared a report (5 Pages) that was identical in many ways to the one filed with the court of seven pages but had deleted any listing of lots. This report was not dated and had not been filed. He had deleted much of the information under 3. Litigation where he previously referred to the many lots at Lake Montezuma, Beaver Valley, and El Cid.

7. Bankruptcy court trustees have been given such power by bankruptcy and Federal judges that they have even been able to get county officials to follow their instructions which works a hardship on investors and deprived them of information.

Investors unable to get information from bankruptcy court appointees wrote county offices about lots they invested in in which they did not have deeds or because they were not sure about recordings. Some who had been promised clear title or substitute lots paid taxes when they did not have recorded deeds. Imagine how surprised they were to receive a letter from the Yavapai County back tax department saying "Please be advised that we are enjoined by the Federal Bankruptcy Court, in regard to issuing any information on property involved in litigation. Mr. James E. Hamblen, 1308 North First St., Phoenix, Arizona 85004, is the trustee and all inquiries should be directed to him. Mr. Hamblen in turn will contact this office and give us his disposition. Thank you."

When I discovered that information was withheld I contacted the chief of the County back tax department who assured me that he was eliminating one step because of bankruptcy but that he would in the future give the information they asked.

**CONTINUED**

**2 OF 3**

8. James Hamblen turned over 30 lots at Montezuma Haven to a realtor in Lake Montezuma area which had never been released from the Amtitle trust for beneficiaries because release payments had not been paid. "For Sale" signs appeared on these lots although investors had paid cash for some, had paid after bankruptcy on contracts or were setting up their own accounts until clear title could be obtained, etc. When we learned that one of these lots had been sold and a mobile home had been placed on the property before court approval we investigated. We found that Hamblen was merely setting aside the claims of the investors and that the River Valley Land and Trust Co. as beneficiary of the trust had agreed that plaintiff, James Hamblen could proceed to offer and sell 30 lots for release prices of \$1,100 for five of the lots and \$1,400 for the remainder. Also could sell the 14 unsubdivided real property for releases of \$2,400 an acre. Yet when individuals who had invested in lots had tried to pay release prices and save their entire investments they were told by Amtitle Trust Co. as trustee for beneficiaries that they would have to pay over \$5,100 a lot. They were adding all interest due on all the lots on individual releases.

Lester Penterman, attorney for trustee James Hamblen recorded a stipulation May 19, 1977, signed by himself and Assistant U.S. Attorney James Loos that any real property in the debtor estate may be sold free and clear of liens filed by the Internal Revenue Service. Penterman prepared an order and Judge Vincent Maggiore signed this that the liens are hereby declared null and void as a secured claim against any real property in the estate. This was recorded May 19, 1977 also.

However in the complaint filed to enable the trustee to sell Montezuma Haven lots that had not been released from the trust when sold to investors signed October 21, 1977, stated under IV that "all unrecorded claims against the said parcel of real property are subject to and subordinate to all liens of record. They even list liens 61421, 61912, 62039 and 63116 which are the ones they had declared null and void by a court order.

Federal investigators and prosecutors I am sure would never permit company officials to sell land they did not own for cash or on contract and then set aside their claims, sell the land to someone else and pay the release price. Yet this is exactly what happened in several cases in Montezuma Haven whereby claims were set aside. All 30 of these lots would have been taken and sold if MVRI had not appeared at court hearing and complained.

When those who invested in lots filed an answer to the complaint so they would not lose by default, they were forced to have pretrial hearing, sent letter regarding adversary proceedings "K," told that they should be represented by an attorney and were not permitted to state their case but listened to the judge and the attorney for the trustee talk at great length. Investors learned that it was prohibitive to have an attorney represent them because of the way they dragged on these proceedings. Also a number of attorneys refused to represent individuals in these bankruptcies because they realized they would have to charge more than the person might have invested if the proceedings dragged on and on. A mockery is made of justice in these cases.

9. For years MVRI attempted to get investors clear title to lots where the deeds had been issued by one company and the lot released to a related company. By 1977 we were able to clear title to all but four in the Montezuma Haven area by the trustee simply issuing a deed from all three of the related companies.

Although we had pointed out that the category sheets prepared by the bankruptcy trustee were in error with hundreds of mistakes court appointees refused to correct these simple errors or permit Amtitle to do this.

One of the investors in one of the four lots had obtained services of an attorney who had them pay for a title report and then wrote them "There aren't many ways that the condition of title could be worse." We encouraged the purchaser to protest the paying of fees to trustee until this simple deed of transmittal could be obtained. At the court hearing in February of 1978, when the investor was attempting to explain the situation, the trustee's attorney Lester Penterman interrupted and asked the judge if he could clarify the situation. Judge Maggiore permitted him to explain and everything he told the judge was wrong. He said the lot had never been released from the trust, that there were two other purchasers of the same lot and two assignees and this was the reason they could not give her clear title to the lot and furthermore she did not have a recorded deed. Mrs. J. kept shaking her head "no" and finally the judge per-

mitted her to comment. She had been interrupted again and again and even asked by the judge if she thought trustee Jennings was responsible for her problems. She was too nervous to explain so she asked the judge if I could relate her situation. The judge reluctantly permitted this. I simply said that Attorney Penterman was entirely wrong. They did have a recorded deed, there were no other purchasers because the two shown on the category sheets were in error and there were five errors on that one lot alone. I further explained that one couple shown on that lot was there in error and was also on the category sheet for a Montezuma Park lot which they had purchased. The other couple shown as purchaser of this lot had never bought a lot at Lake Montezuma but had purchased a lot at Oak Creek Village, which was one of the developments where trustee Jennings was part owner. She had purchased this lot in a trade agreement with a purchase price of \$15,995, and credit for her Chino lots of \$4,895 and had paid cash of \$1,000 on the trade. Kenneth Edgar of Edgar Marketing had sold her and her husband this lot without telling her that the property owners were to be assessed for the indebtedness left by Big Park development plus an assessment of \$11.00 per month for upkeep. She also wrote us that the lot was overpriced 50 percent.

Attorneys representing individual clients as well as our organization notified court appointees that clear title could be given to investors and the errors rectified if the trustee would merely deed these many lots from Great Southwest Land and Cattle Corp. to Lake Montezuma Development Corporation. We also contacted Amtitle Trust Co., trustee for the beneficiaries of lots in Montezuma Haven who admitted that errors had been made. In 1975 Amtitle wrote us they were still attempting to get approval of the Bankruptcy Court to order the present trustee to correct this matter. Yet 3 years after bankruptcy court appointees ruthlessly refused to have the proper recordation of the deeds and perfect the chain of title to the various lot owners. In 1977 Amtitle wrote us that they were prevented by the Bankruptcy Act from unilaterally executing such deeds as prior to such action, Amtitle needs the consent of the Bankruptcy Court.

To show how bankruptcy court appointees work to make it as difficult as possible for investors one couple had paid cash for their Montezuma Haven lot only to discover they did not have clear title but simply needed a deed of transmittal from one of the companies to the other. They obtained the services of an attorney right after county records showed the lot was still held by Great Southwest LCC in 1972. Although they were one of the few who had title insurance they did not receive clear title until 1975, 3 years after bankruptcy. The attorney representing American Title Insurance Co. and Amtitle Trust Company wrote the attorney representing the couple "Hopefully we can get this matter resolved without objection on the part of anyone interested in the three bankruptcy proceedings to whom notice of our petition has been given. In addition to sending notices to the people who have filed 210 statements in the bankruptcy proceedings, the court has ordered us to publish the notice of hearing on the petition in the same manner required for service of legal process under Arizona Rules of Civil Procedures. This explains why this matter has been deferred for hearing until October 24, 1974. In this August 13, 1974 letter he wrote that they were doing their level best to perfect title in their clients. Although there were no other purchasers of this lot nor any assignee who had bought the mortgage contract and Exhibit "A" Trust Agreement showed that Great Southwest Land and Cattle Corp. assigned to Lake Montezuma Develop. Corp. 100 percent of the 2nd beneficial interest in Trust No. 6192 on February 18, 1971, and LMDC approved and accepted the same subject to all the terms, covenants and condition of said trust, it was not until April of 1975 that the bankruptcy trustee issued a quit-claim deed giving clear title. Some others did not receive clear title to lots until April of 1978 although our organization years previously had notified both bankruptcy and Federal judges that all that was needed were simple deeds of transmittal to correct mistakes before bankruptcy whereby lots were released to the wrong company. It was not until 1978 after investors and members of our organization were finally permitted to be heard at court hearings that all the lots that had been released to the wrong company in Amtitle trust were released to the company that had issued the deeds and clear title was obtained.

Another group who purchased Montezuma Haven lots had a more serious problem. Their lots had never been released from the Amtitle Trust because the swindlers did not pay the release prices before bankruptcy. A Sun City

couple discovered that the lot on which they had been paying after bankruptcy had not been released from the Amtitle Trust although they had merely been placed in category "E" by court appointees which told them only that nothing had been recorded in regard to their purchase and deceived them by stating the lot was owned. They had paid \$522 down and a total of \$2,093.74 to April of 1973 when they learned of their problem. They engaged an attorney to obtain the release of the 12 payments of \$1,042 paid after bankruptcy and held in trust by Central Service collection agency. Fortunately no one had purchased their mortgage contract. Only Cochise College Park was shown as assignee on category sheet, and they had merely sold most of these mortgage contracts to hundreds of investors across the country after assignments were recorded in the name of CCPI on a number of other contracts.

The court appointees and also the trustee of Cochise College Park and his attorneys tried in every way they could to prevent this couple from having these payments made after bankruptcy returned when they could not get title to the lot. There are 20 docket numbers on this case after the complaint was first filed December 4, 1973. This included summons and notice of trial of adversary proceedings set for February 6, 1974 signed by Judge Vincent Maggiore. Then opposition to motion to dismiss complaint made by trustee when they ruthlessly attempted to misquote the law and state this required permission of the chapter X court to initiate proceedings although there is nothing in bankruptcy rules which requires permission of the court to file a complaint. Then they attempted to dismiss complaint in that there was presently class action to determine rights of assignees although this couple never were purchasers of promissory note so would not be included. Then trustee Wallace Perry of CCPI and attorneys filed an answer that they may have some interest in and to the notes and mortgages described in complaint. Pretrial was set for March 27, 1974, and motion to dismiss taken under advisement. There were 11 more docket numbers until August 15, 1974, when Brown, Vlassis and Bain attorney stated it was the position of the cotrustees that a decision of court granting relief sought by plaintiffs may at this time be premature. Also that granting relief in this case may set a precedent in these reorganization proceedings et cetera, et cetera. Finally U.S. District Judge Carl C. Muecke on August 16, 1974, ordered that the plaintiffs do recover \$1,142.04 and execution of a quit claim deed for any interest they had in lot 2 was executed.

Of course those learning of such lengthy and unnecessary proceedings realized that it would be prohibitive in cost to attempt to obtain refunds with legal help. Some who had paid cash for Montezuma Haven lots or had been deceived into paying on lots they could never own after bankruptcy attempted to pay the release price of \$1,400 which the company failed to pay before selling the lots. Others who had made many payments after bankruptcy also attempted to save their investment by paying release price. One received a reply May 30, 1974, from Amtitle as trustee that the release price on lot 37 Montezuma Haven would be \$5,108.86 computed to July 1, 1974. This elderly widow then wrote Amtitle to explain why they were asking more than the cash price of the lot as a release price. She received a complicated reply about two trusts and unpaid balance due first beneficiary and stated "The first beneficiary of Trust No. 6192 is entitled to \$5,108.86 as a release price and from that amount the sum of \$614.46 is due the First Beneficiary of Trust No. 6191. They also admitted that they could not proceed without direction from the court and until such time as the release prices had been paid to the beneficiaries under both trusts. They avoided the truth that they were simply adding all the interest due on all the lots held in trust to the release price of each lot. Copy of this letter was sent to Attorney Philip Higdon representing bankruptcy cotrustees. On May 30, 1974, Amtitle trust officer had written an attorney that trust No. 6191 provision was the lot release price was \$486.00 plus \$106.49 interest to July 1, 1974, and the provision of trust No. 6192 required payment of \$1,000, plus interest of \$3,494.40 to July 1, 1974.

Jay Lippard, former vice president of the fraud ridden GSWLCC and LMDC, was employed by Amtitle Trust Co. of Phoenix before being sentenced to prison for fraud.

During the years Irving Jennings and Louis Melczer were cotrustees not one lot was substituted where there were prior claims by other investors or lots had not been released from trusts. Yet they had promised this in 1972.

It was in March of 1978, after the court hearing in February, that attorney Lester Penterman, wrote Charles Hallett, who had taken over as trustee and

replaced James Hamblen. He stated that, "From correspondence and records reviewed, it appears that a corrective deed should be executed by the Trustee to clear title to the Lot 65, Montezuma Haven—Jensen and Lots 25, 38, and 62 Montezuma Haven. To do this, it appears that a deed should be executed from Great Southwest Land and Cattle Corp. to Lake Montezuma." He then went on that there is a gap in the title, and to clear this gap, a deed from Great Southwest to Lake Montezuma should be recorded on the following lots: Lot 65, 25, 38, and 62. On April 6, 1978 Charles Hallett, trustee had warranty deed from Great Southwest Land and Cattle Corp. to Lake Montezuma Development Corp. recorded on these four lots. Amtitle Trust Company then informed us what had been done.

There were 20 docket numbers with hearings lasting many months when an elderly couple represented by an attorney attempted to get their contract payments returned to them after bankruptcy court trustee had placed them in the wrong category so they were unaware that their lot had not been released from trust and continued making payments on lot they could never own. Not only did the trustee and attorneys representing him make every effort to deprive them of the return of these funds but the trustee for Cochise College Park Inc. bankruptcy reorganization and attorneys representing him tried to prevent the withdrawal of funds even though there was no record of anyone having purchased the mortgage assignment. Cochise College Park Inc. has never been able to present any evidence that they purchased any mortgage assignments although they are shown on hundreds as assignee when James Cornwall, president, signed mortgage assignments and they in turn sold these contracts to individuals.

Those caught in the fraud and trying to obtain information were subjected to ridicule and before they could ever ask a question or state a fact they were asked by Judge Maggiore if they had legal representation. Several times these individuals stated that they were attempting to get information to determine if they needed legal counsel.

It was apparent from the start there was a close bond between judge, trustees, and attorneys representing them which is referred to as the "bankruptcy ring" in the lengthy report released by the U.S. House Judiciary Comm. Trustees and attorneys merely had to present orders or petitions and they were approved.

Investors caught in the fraud were unable to present anything that was done in "the proper manner". Yet they were never informed as to the proper procedure and attorneys representing them could not obtain information. We had attorneys from Arizona and out-of-State call us on the phone or write us for information saying they could not get any replies from either the trustee, attorneys representing him or the bankruptcy judge.

We have copies of some of the letters written later in the bankruptcy proceedings by Judge Maggiore. He wrote a Wyoming couple that there was presently pending three suits against alleged wrong doers brought by the initial trustee to remove liens and seek damage against the alleged fraudulent "land promoters." He also stated that the case they inherited was completely lacking in liquid assets or necessary records. Very good records were available to the trustee from Central Service which he did not use. If he had he would not have had hundreds of errors on the category sheets and omitted so many legitimate assignees showing only Cochise College Park as the assignee when they only sold the mortgage contracts to individuals both on legitimate as well as fraudulent contracts. Central Service Bureau, who took over as collection agency from Standard Land Title and Trust Agency shortly before the planned bankruptcy, was unable to get proper records from this agency but had copies made of all the lot purchase records showing whether payments had been made on contracts, or whether there were assignees and other information. They obtained these from records at the Great Southwest Land and Cattle Corp. offices just before the collapse of the companies. They also furnished trustee Jennings copies of their collections made and disbursements to assignees before the temporary restraining order was obtained from Federal judge Walter E. Craig which became effective in April of 1972 although signed later. For most investors the funds were never released until December of 1979. Because of the way these proceedings were conducted attorneys representing lot purchasers in one class action and assignees in another suit against trustee Irving Jennings Jr. et al they collected \$107,249.38 in fees and expenses of the \$449,349.69 held by the restraining order over the years.

In the Cochise College Park Inc. bankruptcy, the fees in that bankruptcy case were near \$750,000 according to newspaper article of February 1976 with

Charles M. Duecy, a Scottsdale attorney, already receiving approximately \$160,000 in fees and that he would ultimately receive more than \$260,000 in fees and expenses for about 3 years work in handling a class action suit against Wallace Perry, trustee for Cochise College Park in bankruptcy reorganization proceedings. U.S. Judge Carl Muecke order directed Perry to pay attorney Duecy \$160,000 as "prepayment of an estimated portion of his attorney fees." Wayne Brown and Co., accountant for the receiver was awarded \$199,242 and fees to Transamerica Title totaling \$81,904 to reconstruct the records.

Due to the way the bankruptcy was handled and the fact that Charles Duecy only represented assignees, a Fort Worth attorney, Don Gladden, who represents a group of lot purchasers in Cochise College Park, has filed a suit against Wallace Perry, trustee. Perry as trustee allegedly induced Gladden's clients to continue making their payments monthly, assuring them that collections would be placed in an escrow. Instead Perry used the lot buyers' money to defray the cost of administering the bankruptcy proceedings, court records revealed. Outlays totaling about \$130,000 of funds claimed by Gladden's clients went to Perry's attorneys, accountants and others.

When last we heard over 2 years from the time this judgment was asked in December of 1977 a hearing had been scheduled again before Judge Maggiore on December 3, 1979. The attorney had promised to inform us if anything happens at that time and not hearing we assume there are more delays.

Certainly it should now be apparent to those reviewing these pages that these planned bankruptcies resulting in reorganization proceedings actually protect the swindlers because no report of the great fraud is sent to investors as the law requires. Apparently this would discourage too many from continuing payments on lots purchased until they learned if they had clear title or the improvements promised. These proceedings also benefit court appointees and those filing class action suits. Many of the investors do not even get their payments returned on lots they can never own because address changes were not made by court appointees and these investors cannot be reached. Others have worthless lots without improvements and their recreational facilities never reclaimed from swindler as officer of the company. Yet their payments on lots that many were led to believe were improved lots were released to assignees of which lot investors had no idea existed as they were never told their mortgages were assigned to individuals.

Yet the victims of the fraud are constantly told that the proceedings are being conducted for their benefit. Judge Maggiore wrote one couple. "The fact that the 'developer swindlers', as you state, have documented deeds or made promises to you do not necessarily mean that you were protected. Your protection would have been made more certain if you had sought legal advice at the time you purchased the property." Then "the legal profession can only protect your rights if you seek their advice before you purchase property."

It should interest Judge Maggiore that there are attorneys among those swindled both who bought mortgage contracts or lots. Then Judge Maggiore states that they should be "aware that administrative costs are increasing because of the unwarranted demands of thousands of injured parties." The costs have soared and huge amounts asked in fees because of the way the bankruptcy proceedings were handled. Any good accountant with a little help could have cleared up this bankruptcy long ago and with justice to those swindled. Near the close Judge Maggiore states "The only reason we have not abandoned all of the potential interests are because the trustees have felt that there may be some salvaging for some parties still possible". However, with the huge fees submitted of \$234,487. for Brown and Bain which includes fees for former attorney Bruce Babbitt as well as other attorneys representing Irving Jennings, trustee; and James Hamblen using interim fees of \$104,150 plus additional \$55,780. and attorney Lester Penterman asking \$94,844.; it appears likely that there will be nothing for those swindled as Charles Hallett, most recent trustee stated in an article published.

One of the residents of Lake Montezuma, who was chosen as one of three as a creditor's committee in 1977 in regard to the compromise settlement of a suit against former developers who sold to the bankrupt company, wrote about the settlement helping the victims. The trustees and attorneys before the settlement was agreed upon had assured all three of the committee that this would benefit those caught in the fraud. However, when the cash settlement of \$331,250 was

received plus mortgages of \$5,750 and balance due on contracts of \$9,900 and in addition 59 Lake Montezuma Lots Judge Maggiore wrote this party he had chosen for the creditors' committee: "Unfortunately the above entitled proceeding in its entirety has been misunderstood." Then added "The court did not say that the cash settlement would directly benefit the purchasers of the lots. The court said that the proceeds after administrative expenses were paid would benefit all of the creditors who have an unsecured position. The lot purchasers in accordance with law do not have any right as against the trustee if they did not properly record. These people caused their own problem by not seeking advice at the time they negotiated the transactions with the parties responsible for the fraud." Judge Maggiore is not even aware that these victims never had a chance to record the original documents because in so many cases they never received deeds or mortgage assignments. Then when they complained to State real estate commissioner, State attorney general, county attorneys and others including the U.S. attorney they received no help. Their complaints were ignored or they received form letters stating that their cases would be reviewed and they would be informed. They received nothing more. We researched these many cases thoroughly so our organization could fully understand the problems these investors faced.

One couple whose trust funds had been withdrawn without court order by Irving Jennings and who did not have title to the lot as it had never been released from the trust wrote Judge Maggiore concerning this. "If the trustee had used money without order of the court for the benefit of the estate, either the trustee or the estate should pay these monies back. However, the court cannot on its own motion take action against the trustee or the estate, but must await a filing of a complaint in order to grant due process as required by law." Thus the many complaints from those who had funds withdrawn who did not have title to lots and whose mortgage assignments had not been sold as well as legitimate assignees who had payments belonging to them withdrawn were ignored. Judge Maggiore stated that "Great Southwest/Montezuma has been a difficult case, more so because of a change over the trustee and attorney. The previous attorney became Arizona attorney general. The previous trustee attempted to resign because of personal problems." The problems that Irving Jennings was actually having was that the former attorney general of Arizona had filed a consumer fraud suit against him and associates in November of 1974 in regard to the Oak Creek Village (Big Park) development. Judge Maggiore then sent copies to Federal Judges Craig and Muecke, James Hamblen, trustee, U.S. Attorney of Arizona, FBI, U.S. Security and Exchange Commission, U.S. House judiciary Committee and attorney Amelia Lewis.

Charles Hallett became the trustee when James Hamblen was relieved of his duties as trustee when his bookkeeper in the one bankruptcy case (Thomas Grosso Investment Co. was found guilty and sentenced for embezzlement of bankruptcy estate funds).

It seemed incredible to many to receive the notice of first meeting of creditors after adjudication and of automatic stay dated August 28, 1978, signed by Bankruptcy Judge Vincent D. Maggiore in which the following appeared:

"It is further ordered That all persons, firms, and corporations who are or claim to be creditors of the above named bankrupts, (ECSI, LMDC, GSWLCC), together with their agents, attorneys or any person claiming through them, be and they are hereby jointly and severally restrained and enjoined from contacting or harassing the petitioners, either directly or indirectly or interfering with the rights of the petitioners to so file or from contacting the employers of said petitioners, \*\*\*"

The law states clearly that the court appointed trustee has all of the rights that the bankrupt had. However, can you imagine any company official informing investors in the company that he or his employees cannot be contacted? This notice closes with "Notice is further given that based upon the present record and funds available and pending priority claims, court costs and administrative costs and fees, subject to review by said Court, it is improbable that unsecured creditors will be paid a dividend."

Charles Hallett, trustee then issues a trustee's deed of real estate to Jimmy F. Sneed and Eugene E. Tchumy and attaches an exhibit which lists 18 Lake Montezuma lots which are included in the sale of the Lake Montezuma Golf and Country Club. However, two of the lots in Montezuma Park Unit 7 lots 59 and 94 were reclaimed by Herbergers by court order in 1973, resold to Edgar Marketing

with no down and small down payments who resold them at far more than their value to two different elderly widows (one 93 years of age). They were not aware that these lots were still in the Herberger trust. These lots have once again been reclaimed by Herberger Enterprise Inc. with Minnesota Title Company as trustee. (James Hamden, former trustee was not even aware of which lots were reclaimed by Herberger trust and included these in the agreement.)

Charles Hallett in his report filed July 15, 1978, that which many of us were aware of from the beginning of the reorganization proceedings but all our petitions to have the bankruptcy reorganization under title X ended and to conduct this under straight bankruptcy were in vain. Mr. Hallett, trustee, states "Upon said examination and investigation, it also became apparent from the records that the debtors were and are insolvent and also that it is unreasonable to expect that a plan of reorganization can be affected as required under the provisions of the Bankruptcy Act and also that a classification of creditors is not possible or feasible at the present stage of Chapter X administration. A motion to convert the Chapter X cases to straight bankruptcy was duly filed on May 3, 1978 when it became apparent that it was not possible to formulate a plan which was feasible, the debtors being insolvent in all respects pertinent to these proceedings."

On the 10th of January 1979 Judge Maggiore signed the notice and later approved of the bulk sale of real property of large lot subdivisions at wholesale prices in Gila County to E. G. Hetmanek, a buyer knowledgeable and sophisticated in the land sales business and believed to own land in the area, on contract free and clear of liens. E. G. Hetmanek was able to buy 75 lots at \$100 a lot or the total price of \$7,500 and included in the above mentioned lots is parcel D, including buildings and appurtenances thereto consisting of water facilities located thereon.

Thus all the claims of investors where the developers did not record their lot purchases or mortgage assignments lost their entire investment. Once again we wonder why the Phoenix law firm that represented the Indiana assignees did nothing about this as two of their clients had purchased mortgage contract assignments on lots 10 Beaver Valley Estates, Unit 5, Gila County and Beaver Valley Estates Unit 3, lot 98. The cost to them was \$6,493.25 to \$3,116.50 for the two lots. Flora Schlicht wrote us that she had not even been sent a notice of the proposed sale and approval for \$100 each so these investors never had a chance to buy the lots to save their large investments. Justice? Would a developer who was not involved in bankruptcy be permitted to set aside the claims of investors because officials he had replaced had not recorded the mortgage assignments and then resell these lots? Not according to the laws in our country but it is apparent to many that bankruptcy appointees with the approval of bankruptcy and Federal judges act is if no such laws existed. Federal prosecutors notified of this do absolutely nothing to protect these investors. Thus can you blame the investors caught in this bankruptcy for stating that the bankruptcy court is above the law and there is no justice for most of them?

An article appeared in the March 12, 1978 Arizona Republic regarding the Lake Havasu Estates Corp. case regarding "junk land" sold. Nine principals of Lake Havasu Estates were convicted after swindling the public out of \$6 million.

On March 24, 1978 we wrote the Minnesota attorney general as to whether the Federal court had given Charles Hallett permission to sell lots in Lake Havasu without compliance with Federal and State laws. Thomas R. Mucke assistant attorney general, securities division, wrote us that "A motion pertaining to the issue is pending before the court now and has been since August of 1977. A ruling is expected soon."

On February 13, 1978, Barry R. Greller, special assistant attorney general wrote me as research chairman of Montezuma Vested Rights Inc. and stated that Attorney General Warren Spannaus had asked him to respond to correspondence regarding Arizona land sales companies. He enclosed a copy of a letter directed by a member of their staff to a subcommittee of the U.S. House of Representatives regarding bankruptcy proceedings in the State of Arizona in which their office is presently appearing.

The letter was dated August 16, 1977, and was to Representative Charles E. Grassley, Subcommittee on General Oversight and Renegotiation of Committee on Banking Finance and Urban Affairs. "I believe that an appropriate issue for Congress's determination at the present time would be the power of bankruptcy

courts in Chapter 10 reorganization proceedings to, in substance, preempt the application of both the Federal Interstate Land Sales Act and State Subdivided Land Sales Act. In a bankruptcy proceeding which is currently ongoing in a district court in Arizona—Lake Havasu Estates, Terra-Firm, Inc.; Western Land Wholesales, Debtors, State of Minnesota v. Charles H. Hallett. United States District Court of Arizona is considering an application by the trustee to allow the trustee to sell subdivided lands to residents of a number of states without compliance with either the federal act or the state acts. I do not believe that the Congress ever intended to confer such authority on bankruptcy courts and possibly an amendment to either the statutes conferring authority upon bankruptcy courts or to the interstate land sale law would be appropriate to clarify this matter."

We were notified that the bankruptcy reform act was not completely processed until November 6, 1978, and that the bill was the largest in volume passed during the 95th Congress and took much of the subcommittee's time. The great problems in the past was not with the law but the fact that it was violated in so many ways by court appointees and with approval by bankruptcy and Federal judges. As we stated before they merely "rubber-stamp" almost anything that court-appointed trustees and their attorneys petition for regardless of whether it violates the bankruptcy law with no regard for the victims who expect justice in our Federal courts.

Many have lost all respect for the Federal bankruptcy court of Phoenix since we have done this extensive research and have contacted and been contacted by so many investors as well as officials from all across the country.

Mr. DeCONCINI. Thank you.  
[Whereupon, the hearing was concluded.]

**END**